1065/inst./990

1990

Department of the Treasury
Internal Revenue Service

Instructions for Form 1065

U.S. Partnership Return of Income

(Section references are to the Internal Revenue Code unless otherwise noted.)

Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to IRS
1065	57 hrs., 24 min.	27 hrs., 35 min.	52 hrs., 59 min.	6 hrs., 42 min.
Schedule D (Form 1065)	5 hrs., 1 min.	2 hrs., 12 min.	5 hrs., 10 min.	48 min.
Schedule K-1 (Form 1065)	27 hrs., 44 min.	10 hrs., 23 min.	25 hrs., 16 min.	4 hrs., 1 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making these forms more simple, we would be happy to hear from you. You can write to both the **Internal Revenue Service,** Washington, DC 20224, Attention: IRS Reports Clearance Officer, T:FP; and the **Office of Management and Budget,** Paperwork Reduction Project (1545-0099), Washington, DC 20503. **DO NOT** send the tax form to either of these offices. Instead, see the instructions on page 2 for information on where to file.

Changes You Should Note

- New **Form 8752,** Required Payment or Refund Under Section 7519, has been developed to figure and report the amount the partnership must pay (or will receive as a refund) if the partnership has in effect an election under section 444 to have a tax year other than a required tax year. The new form eliminates the use of **Form 720,** Quarterly Federal Excise Tax Return, for this purpose. In addition, the **Computation Schedule for Required Payment Under Section 7519** is no longer needed and has been removed from these instructions.
- New **Form 8825,** Rental Real Estate Income and Expenses of a Partnership or an S Corporation, has been developed to report income and expenses from rental real estate activities of the partnership. The new form, which provides space for up to eight rental properties, replaces former Schedule H on Form 1065. The net income or loss from rental real estate activities from Form 8825 is carried to line 2 of Schedule K on Form 1065.
- New **Form 8826,** Disabled Access Credit, has been developed as a result of the addition of section 44 by the Revenue Reconciliation Act of 1990. This allows eligible small businesses to claim a new nonrefundable income tax credit equal to 50% of expenses that are over $250 but not more than $10,250. These expenses must be paid or incurred after November 5, 1990, to enable a small business to comply with the requirements of the Americans With Disabilities Act of 1990. An eligible small business is one with gross receipts of $1 million or less in the previous tax year or one that had not more than 30 full-time employees in the previous tax year.

Examples of expenses eligible for the credit include amounts paid or incurred: **(1)** to remove barriers that prevent a business from being accessible to, or usable by, individuals with disabilities; **(2)** to provide qualified interpreters or other methods of making audio materials available to hearing-impaired individuals; **(3)** to provide qualified readers, taped texts, and other methods of making visual materials available to individuals with visual impairments; or **(4)** to acquire or modify equipment or devices for individuals with disabilities.

- For property contributed to a partnership after October 3, 1989, the Revenue Reconciliation Act of 1989 amended section 704(c) to require the contributing partner to recognize gain or loss on a distribution of such property to another partner within five years of being contributed. The gain or loss is equal to the amount that the contributing partner would have recognized, as a result of the difference between the basis and value of the property upon its contribution, if the property had been sold for its fair market value when distributed.

General Instructions

Note: *In addition to the publications listed throughout these instructions, you may wish to get:* ***Pub. 334,*** *Tax Guide for Small Business;* ***Pub. 535,*** *Business Expenses;* ***Pub. 541,*** *Tax Information on Partnerships;* ***Pub. 550,*** *Investment Income and Expenses; and* ***Pub. 556,*** *Examination of Returns, Appeal Rights, and Claims for Refund.*

The above publications and other publications referenced throughout these instructions may be obtained at most IRS offices. To order publications and forms, call our toll-free number 1-800-TAX-FORM (829-3676).

Purpose of Form

Form 1065 is used to report the income, deductions, gains, losses, etc., from the operation of a partnership.

Who Must File

Every partnership that engages in a trade or business or has income from sources in the United States must file Form 1065. A partnership must file even if its principal place of business is outside the United States or all its members are nonresident aliens.

Religious and apostolic organizations exempt from income tax under section 501(d) must file Form 1065.

A qualifying syndicate, pool, joint venture, or similar organization may elect under section 761(a) not to be treated as a partnership for Federal income tax purposes and will not be required to file Form 1065 except for the year of election. See section 761(a) and Regulations section 1.761-2 for more information.

Real estate mortgage investment conduits (REMICs) must file Form 1066.

Certain publicly traded partnerships treated as corporations under section 7704 must file Form 1120.

Note: *If a partnership return is filed by an entity for a tax year, but it is determined that the entity is not a partnership for that tax year, the consolidated partnership audit procedures of sections 6221 through 6233 will generally apply to that entity and to persons holding an interest in that entity. See Temporary Regulations section 301.6233-1T for details and exceptions.*

Electronic Filing of Form 1065

Qualified tax return filers can file Form 1065 and related schedules electronically or on magnetic media. If the partnership files its return electronically or on magnetic media, it must also file **Form 8453-P,** U.S. Partnership Declaration and Signature for Electronic/Magnetic Media Filing. See **Pub. 1524,** Procedures for Electronic/Magnetic Media Filing of Partnership Returns, Forms 1065, for Tax Year 1990 (Magnetic Tape, Floppy Diskette, or Electronically).

When To File

Generally, a domestic partnership must file Form 1065 by the 15th day of the 4th month following the close of its tax year. A partnership in which all partners are

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nonresident aliens must file its return by the 15th day of the 6th month following the close of its tax year.

If you need more time to file a partnership return, file **Form 8736,** Application for Automatic Extension of Time to File Return for a U.S. Partnership, REMIC, or for Certain Trusts, for an automatic 3-month extension. File Form 8736 by the regular due date of the partnership return.

If, after you have filed Form 8736, you still need more time to file the partnership return, file **Form 8800,** Application for Additional Extension of Time to File Return for a U.S. Partnership, REMIC, or for Certain Trusts, for an additional extension of up to 3 months. To obtain this additional extension of time to file, you must show reasonable cause for the additional time that you are requesting. Form 8800 must be filed before the extended due date of the partnership return.

Period To Be Covered by 1990 Return

Form 1065 is an information return for calendar year 1990 and fiscal years beginning in 1990 and ending in 1991. If the return is for a fiscal year, fill in the tax year space at the top of the form.

Note: *The 1990 Form 1065 may also be used if: (1) the partnership has a tax year of less than 12 months that begins and ends in 1991; and (2) the 1991 Form 1065 is not available by the time the partnership is required to file its return However, the partnership must show its 1991 tax year on the 1990 Form 1065 and incorporate any tax law changes that are effective for tax years beginning after 1990.*

Where To File

Use the preaddressed envelope. If you do not use the envelope, file your return at the applicable IRS address listed below.

If the partnership's principal place of business or principal office or agency is located in ▼	Use the following Internal Revenue Service Center address ▼
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Florida, Georgia, South Carolina	Atlanta, GA 39901
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Illinois, Iowa, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	Philadelphia, PA 19255

A partnership without a principal office or agency or principal place of business in the United States must file its return with the Internal Revenue Service Center, Philadelphia, PA 19255.

Penalties

A penalty is assessed against the partnership if it is required to file a partnership return and it: (1) fails to file the return by the due date, including extensions, or (2) files a return that fails to show all the information required, unless such failure is due to reasonable cause. The amount of the penalty is $50 for each month or fraction of a month (for a maximum of 5 months) the failure continues, multiplied by the total number of persons who were partners in the partnership during any part of the partnership's tax year for which the return is due. This penalty will not be imposed on partnerships that meet the exceptions outlined in section 6231(a)(1)(B), provided all partners have timely filed income tax returns fully reporting their shares of the income, deductions, and credits of the partnership. A partnership meets the exceptions of section 6231(a)(1)(B) if it is not subject to the consolidated audit procedures of sections 6221 through 6233 (i.e., the answer to Question M is "No"). See Revenue Procedure 84-35, 1984-1 C.B. 509, for details.

Family-farm partnerships, family-owned wholesale or retail store partnerships, co-owners of investment property, etc., may not have to complete Schedules L and M. See the instructions on page 9 for Question N before completing Schedules L and M.

For each failure to furnish Schedule K-1 to a partner when due and each failure to include on Schedule K-1 all of the information required to be shown (or the inclusion of incorrect information), a penalty of $50 may be imposed with respect to each Schedule K-1 for which a failure occurs. The maximum penalty is $100,000 for all such failures during a calendar year. If the requirement to report correct information is intentionally disregarded, each $50 penalty is increased to $100 or, if greater, 10% of the aggregate amount of items required to be reported (and the $100,000 maximum does not apply). See sections 6722 and 6724 for more information.

Unresolved Tax Problems

IRS has a Problem Resolution Program for taxpayers who have been unable to resolve a problem with the IRS. If the partnership has such a problem, write to the partnership's local IRS District Director or call the partnership's local IRS office and ask for Problem Resolution assistance. This office will take responsibility for your problem and ensure that it receives proper attention. Hearing impaired persons who have access to TDD equipment may call 1-800-829-4059 to ask for help from Problem Resolution. Although the Problem Resolution Office cannot change the tax law or make technical decisions, it can frequently clear up misunderstandings that may have resulted from previous contacts.

Accounting Methods

Figure ordinary income by the accounting method regularly used in maintaining the partnership's books and records. Generally, permissible methods include the cash method, the accrual method, or any other method authorized by the Internal Revenue Code. The method used must clearly reflect income. (See section 446.)

Generally, a partnership may not use the cash method of accounting if: **(a)** it has at least one corporate partner, average annual gross receipts of more than $5 million, and it is not a farming business; or **(b)** it is a tax shelter (as defined in section 448(d)(3)). See section 448 for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that all events have occurred that determine the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance takes place with respect to the expense. There are exceptions for recurring items.

For long-term contracts (except certain real property construction contracts) entered into after July 10, 1989, taxpayers must generally use the percentage of completion method described in section 460. However, for purposes of the percentage of completion method, the partnership may elect to postpone recognition of income and expense under a long-term contract entered into after July 10, 1989, until the first tax year as of the end of which at least 10% of the estimated total contract costs have been incurred.

Unless otherwise allowed by law, the partnership may not change the accounting method used to report income in earlier years (for income as a whole or for any material item) without first getting consent on **Form 3115,** Application for Change in Accounting Method. See **Pub.**

538, Accounting Periods and Methods, for more information.

Accounting Periods

Under the provisions of section 706(b)(1), a partnership is generally required to have one of the following tax years:

(1) the tax year of a majority of its partners (majority tax year); or

(2) if there is no majority tax year, then the tax year of all of the partnership's principal partners (partners with an interest of 5% or more in the partnership profits or capital); or

(3) if there is neither a majority tax year nor a tax year common to all principal partners, then the tax year that results in the least aggregate deferral of income (see Temporary Regulations section 1.706-1T); or

(4) some other tax year, if: (i) the partnership can establish to the satisfaction of the IRS that there is a business purpose for the tax year; or (ii) the tax year is a "grandfathered" year; or (iii) the partnership elects under section 444 to have a tax year other than a required tax year and to make the payments required by section 7519.

A business purpose for a tax year may be established by showing that the requested tax year is the natural business year of the partnership. Revenue Procedure 87-32, 1987-2 C.B. 396, provides a 25% test for determining whether or not a given tax year is a natural business year. Under the 25% test, the gross receipts for the last 2 months of the requested tax year are divided by the gross receipts for the 12-month period that ends with the last month of the requested tax year. The same computation is also made with regard to the 2 immediately preceding 12-month periods. Generally, if the result of each of these three computations is at least 25%, then the requested tax year is the partnership's natural business year.

Revenue Procedure 87-32 also provides that certain "grandfathered" fiscal years may be retained. Generally, under this provision a fiscal year may be retained if a partnership previously received permission under Revenue Procedure 74-33, 1974-2 C.B. 489 to use a fiscal year (other than a fiscal year that resulted in a 3-month or less deferral of income).

A qualifying partnership may elect under section 444 to have a tax year other than the year required under section 706(b) by filing **Form 8716,** Election To Have a Tax Year Other Than a Required Tax Year. Generally, an election under section 444 may be made only if the deferral period of the tax year elected is not longer than 3 months. Further, a partnership that is a member of a tiered structure, other than a tiered structure that consists entirely of partnerships or S corporations (or both), all of which have the same tax year, may not make or continue an election under section 444.

For a partnership to have an election under section 444 in effect, it must make the payments required by section 7519 and file **Form 8752,** Required Payment or Refund Under Section 7519.

Note: *Under the provisions of section 584(h) the tax year of a common trust fund must be the calendar year.*

Rounding Off to Whole-Dollar Amounts

You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

Recordkeeping

The partnership records must be kept as long as their contents may be material in the administration of any Internal Revenue law. Copies of the filed tax returns should also be kept as part of the partnership's records. See **Pub. 583,** Taxpayers Starting a Business, for more information.

Amended Return

If, after the partnership files its return, it becomes aware of any changes it must make to income, deductions, credits, etc., it should file an amended Form 1065 and an amended Schedule K-1 for each partner. Check the box at Item G(4), page 1, Form 1065. Give a corrected Schedule K-1 (Form 1065) to each partner. Be sure to check the box at Item J(2) of each Schedule K-1 to indicate that it is an amended Schedule K-1.

Note: *If a partnership does not meet the small partnership exception under section 6231(a)(1)(B)(i) or if it is a small partnership that has made the election described in section 6231(a)(1)(B)(ii), the amended return will be a request for administrative adjustment and Form 8082, Notice of Inconsistent Treatment or Amended Return (Administrative Adjustment Request (AAR)), must be filed by the Tax Matters Partner. See section 6227 for more information.*

A change to the partnership's Federal return may affect its state return. This includes changes made as a result of an examination of the partnership return by the IRS. Contact the state tax agency for the state in which the partnership return is filed for more information.

Signatures

General Partner

Form 1065 is not considered to be a return unless it is signed. One general partner must sign the return. If a receiver, trustee in bankruptcy, or assignee controls the organization's property or business, that person must sign the return.

Paid Preparer's Information

If someone prepares the return and **does not charge the partnership,** that person **should not sign** the partnership return.

Generally, anyone who is paid to prepare the partnership return must sign the return and fill in the other blanks in the **Paid Preparer's Use Only** area of the return.

The preparer required to sign the partnership return **must** complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give the partnership a copy of the return in addition to the copy to be filed with the IRS.

Other Forms, Returns, Schedules, and Statements That May Be Required

Forms W-2 and **W-3,** Wage and Tax Statement; and Transmittal of Income and Tax Statements.

Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments.

Form 720, Quarterly Federal Excise Tax Return. A new 10% excise tax applies to the first retail sale of the following items sold after December 31, 1990, to the extent the sales price exceeds the amounts shown: (1) passenger vehicles, $30,000; (2) boats and yachts, $100,000; (3) aircraft, $250,000; (4) jewelry and furs, $10,000. Form 720 is also used to report environmental excise taxes, communications and air transportation taxes, fuel taxes, manufacturers taxes, ship passenger tax, and certain other excise taxes.

Forms 1042 and **1042S,** Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the U.S. that is not effectively connected with a U.S. trade or business. A domestic partnership must also withhold tax on a foreign partner's distributive share of such income, including amounts that are not actually distributed. Withholding on amounts not previously distributed to a foreign partner must be made and paid over by the earlier of: (a) the date on which Schedule K-1 is sent to that partner, or (b) the 15th day of the 3rd month after the end of the partnership's tax year. For more information, see sections 1441 and 1442, and **Pub. 515,** Withholding of Tax on Nonresident Aliens and Foreign Corporations.

Form 1096, Annual Summary and Transmittal of U.S. Information Returns.

Form 1098, Mortgage Interest Statement, is used to report the receipt from any individual of $600 or more of mortgage interest in the course of the partnership's trade or business for any calendar year.

Forms 1099-A, B, INT, MISC, OID, R, and **S.** You may have to file these information returns to report abandonments, acquisitions through foreclosure, proceeds from broker and barter exchange transactions, interest payments, medical and dental health care payments, direct sales of consumer goods for resale, miscellaneous income

payments, nonemployee compensation, original issue discount, total distributions from profit-sharing plans, retirement plans, individual retirement arrangements, insurance contracts, etc., and proceeds from real estate transactions. Also, use these returns to report amounts that were received as a nominee on behalf of another person.

For more information, see the Instructions for Forms 1099, 1098, 5498, and W-2G.

Note: *Every partnership must file information returns if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totaling $600 or more to any one person during the calendar year.*

Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. A partnership that controls a foreign corporation; or that is a 10-percent-or-more shareholder of a controlled foreign corporation; or acquires, disposes of, or owns 5% or more in value of the outstanding stock of a foreign corporation, may have to file Form 5471.

Form 5713, International Boycott Report, is used by persons having operations in or related to "boycotting" countries. The partnership must give each partner a copy of the Form 5713 filed by the partnership if there has been participation in, or cooperation with, an international boycott.

Form 8264, Application for Registration of a Tax Shelter, is used by tax shelter organizers to register tax shelters with the IRS for the purpose of receiving a tax shelter registration number.

Form 8271, Investor Reporting of Tax Shelter Registration Number, is used by partnerships that have acquired an interest in a tax shelter, which is required to be registered, to report the tax shelter's registration number. Form 8271 must be attached to any return on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is taken or any income attributable to a tax shelter is reported.

Forms 8288 and **8288-A,** U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests; and Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests. Use these forms to report and transmit withheld tax on the sale of U.S. real property by a foreign person. See section 1445 and the related regulations for additional information.

Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business, is used to report the receipt of more than $10,000 in cash or foreign currency in one transaction (or a series of related transactions).

Form 8594, Asset Acquisition Statement, is to be filed by both the purchaser and seller of a group of assets constituting a trade or business if goodwill or a going concern value attaches, or could attach, to such assets and if the purchaser's basis in the assets is determined only by the amount paid for the assets.

Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. Partnerships that are not closely held use this form to figure the interest due or to be refunded under the look-back method of section 460(b)(3) on certain long-term contracts entered into after February 28, 1986, that are accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method. If the partnership owes interest, Form 8697 must be attached to the partnership return. However, if interest is to be refunded, Form 8697 is filed separately.

Forms 8804, 8805, and **8813,** Annual Return for Partnership Withholding Tax (Section 1446); Foreign Partner's Information Statement of Section 1446 Withholding Tax; and Partnership Withholding Tax Payment (Section 1446). File Forms 8804 and 8805 if the partnership had effectively connected gross income and foreign partners for the tax year. Use Form 8813 to transmit installment payments of withheld tax based on effectively connected taxable income allocable to foreign partners. However, publicly traded partnerships that do not elect to pay tax based on effectively connected taxable income do not file these forms. They must instead withhold tax on distributions to foreign partners and report and transmit payments using Forms 1042 and 1042S. See section 1446 for more information.

Form 8822, Change of Address, may be used to inform the IRS of a new partnership address if the change is made after filing Form 1065.

Attachments

If you need more space on the forms or schedules, attach separate sheets. Use the same arrangement as the printed forms. **Show the totals on the printed forms.** Put the partnership's name and employer identification number on each sheet. Also, be sure that each separate sheet clearly indicates the line or section on the printed form to which the information relates.

To assist us in processing the return, we ask that you complete every applicable entry space on Form 1065. Please do not attach statements and write "See attached" in lieu of completing the entry spaces on the form.

Definitions

Partnership.—A partnership is the relationship between two or more persons who join to carry on a trade or business, with each person contributing money, property, labor, or skill and each expecting to share in the profits and losses of the business whether or not a formal partnership agreement is made.

The term "partnership" includes a limited partnership, syndicate, group, pool, joint venture, or other unincorporated organization, through or by which any business, financial operation, or venture is carried on, that is not, within the meaning of the Internal Revenue Code, a corporation, trust, estate, or sole proprietorship. If an organization more nearly resembles a corporation than a partnership or trust, it is considered to be a corporation.

A joint undertaking merely to share expenses is not a partnership. Mere co-ownership of property that is maintained and leased or rented is not a partnership. However, if the co-owners provide services to the tenants, a partnership exists.

General Partner.—A general partner is a partner who is personally liable for partnership debts.

Limited Partner.—A limited partner is a partner whose personal liability for partnership debts is limited to the amount of money or other property that the partner contributed or is required to contribute to the partnership.

Limited Partnership.—A limited partnership is a partnership composed of at least one general partner and one or more limited partners.

Nonrecourse Loans.—Nonrecourse loans are those liabilities of the partnership for which none of the partners has any personal liability.

Section 702(a) Items

Under section 702(a), partners are required to take into account separately their distributive shares of the following items (whether or not they are actually distributed):

1. Gains and losses from sales or exchanges of capital assets;

2. Gains and losses from sales or exchanges of property described in section 1231;

3. Charitable contributions (as defined in section 170(c));

4. Dividends (passed through to corporate partners) that qualify for the dividends-received deduction;

5. Taxes described in section 901 paid or accrued to foreign countries and to possessions of the United States;

6. Other items of income, gain, loss, deduction, or credit, to the extent provided by regulations. Examples of such items include nonbusiness expenses described in section 212, intangible drilling and development costs (section 263(c)), and soil and water conservation expenditures (section 175). (See the instructions for Schedules K and K-1 later in these instructions for a more detailed list); and

7. Taxable income or loss (ordinary income or loss) exclusive of items 1 through 6 above.

Elections

Generally, the partnership decides how to figure taxable income from its operations. For example, it chooses the accounting method and depreciation methods it will use. The partnership also makes the elections under the following sections:

- The election under section 1033 to not recognize certain reinvested gain when property is compulsorily or involuntarily converted into money or into property that is not similar or related in use or service.

• The election under section 614 with respect to oil and gas wells or geothermal deposits to treat more than one operating mineral interest in a single tract or parcel of land as separate properties. The partnership must make the section 614 election before the partners compute their individual depletion allowances under section 613A(c)(7)(D). See Revenue Ruling 84-142, 1984-2 C.B. 117. See the instructions for Schedule K-1, line 21, item c, for the information on oil and gas depletion that must be supplied to the partners by the partnership.

• The election under section 754 under which a partnership may elect to adjust: **(a)** the basis of its remaining assets when assets distributed to a partner have increased or decreased in value; **(b)** a new partner's share of the basis of partnership assets to reflect the purchase price paid by a new partner for the new partner's interest; or **(c)** an estate's or other beneficiary's share of the basis of partnership assets to reflect a change in the basis of a partnership interest on the death of a partner. See Regulations section 1.754-1(b) and the instructions for Question R for more information.

• The election under section 179 to expense the cost of certain tangible property. The partnership passes this amount through to the partners. See Form 4562 for more information.

Information about other elections may be found under the applicable sections of Chapter 1 of the Code and the Income Tax Regulations.

Elections under the following Code sections are made by each partner separately on the partner's tax return:

• Section 108 (income from discharge of indebtedness);

• Section 617 (deduction and recapture of certain mining exploration expenditures paid or incurred); and

• Section 901 (foreign tax credit).

In addition, each partner may make an election under section 59(e) to deduct ratably, over the period specified in that section, certain qualified expenditures such as intangible drilling costs, mining exploration expenses, or research and experimental expenditures. See the instructions for Schedules K and K-1, lines 18a and 18b, for more information.

Distribution of Unrealized Receivables and Inventory Items

If a partnership distributes unrealized receivables or substantially appreciated inventory items in exchange for all or part of a partner's interest in other partnership property (including money), treat the transaction as a sale or exchange between the partner and the partnership. Treat the partnership gain (loss) as ordinary income (loss). Allocate the income (loss) only to partners (other than the distributee partner) who will take this amount into account separately under section 702(a)(7).

If a partnership gives other property (including money) for all or part of that partner's interest in the partnership's unrealized receivables or substantially appreciated inventory items, treat the transaction as a sale or exchange of the property. See section 751 and the related regulations for definitions of unrealized receivables and substantially appreciated inventory items.

Generally, if a partner sells or exchanges a partnership interest where unrealized receivables or substantially appreciated inventory items are involved, the transferor partner must notify the partnership, in writing, within 30 days of the exchange. See **Form 8308,** Report of a Sale or Exchange of Certain Partnership Interests, for the types of unrealized receivables involved.

Note: *The transferor in a section 751(a) exchange does not have to notify the partnership of the exchange if, under section 6045, Form 1099-B is required to be filed with respect to the sale or exchange. See Form 8308 for more information.*

See Revenue Ruling 84-102, 1984-2 C.B. 119, for information on the tax consequences that result when a new partner joins a partnership that has liabilities and unrealized receivables. Also, see section 6050K and Pub. 541 for more information.

See section 751(f) for special rules for section 751 exchanges in the case of tiered partnerships.

Partner's Dealings With Partnership

If a partner engages in a transaction with his or her partnership, other than in his or her capacity as a partner, the partner is treated as not being a member of the partnership for that transaction. Special rules apply to sales or exchanges of property between partnerships and certain persons, as explained in Pub. 541.

Contributions to the Partnership

Generally, no gain (loss) is recognized to the partnership or any of the partners when property is contributed to the partnership in exchange for an interest in the partnership. This rule does not apply to any gain realized on a transfer of property to a partnership that would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated. If, as a result of a transfer of property to a partnership, there is a direct or indirect transfer of money or other property to the transferring partner, gain may have to be recognized on the exchange.

The basis to the partnership of property contributed by a partner is the adjusted basis in the hands of the partner at the time it was contributed, plus any gain recognized (under section 721(b)) by the partner at that time. See section 723 for more information.

Notes: *See section 704(c) for the rules regarding partnership allocations with respect to contributed property.*

If a partner contributed unrealized receivables, inventory items, or capital loss property to the partnership, see section 724.

Passive Activity Limitations

In general, section 469 limits the amount of losses, deductions, and credits that partners may claim from "passive activities." The passive activity limitations do not apply to the partnership. Instead, they apply to each partner's share of any income or loss and credit attributable to a passive activity. Because the treatment of each partner's share of partnership income or loss and credit depends upon the nature of the activity that generated it, the partnership must report income or loss and credits separately for each activity.

The instructions below (pages 5-9) and the instructions for Schedules K and K-1 (pages 15-23) explain the applicable passive activity limitation rules and specify the type of information the partnership must provide to its partners for each activity. If the partnership has more than one activity, it must report information for each activity on an attachment to Schedules K and K-1.

Generally, passive activities include: **(a)** activities that involve the conduct of a trade or business if the partner does not materially participate in the activity; and **(b)** all rental activities (see definition on page 6), regardless of the partner's participation. The level of each partner's participation in an activity must be determined by the partner.

The passive activity rules provide that losses and credits from passive activities can generally be applied only against income and tax from passive activities. Thus, passive losses and credits cannot be applied against income from salaries, wages, professional fees, or a business in which the taxpayer materially participates; against "portfolio income" (see definition on page 7); or against the tax related to any of these types of income.

Special provisions apply to certain activities. First, the passive activity limitations must be applied separately with respect to a net loss from passive activities held through a publicly traded partnership.

Second, special transitional rules apply to losses with respect to partnership interests acquired and activities commenced before October 23, 1986, and with respect to losses incurred by investors in qualified low-income housing projects. Third, special rules require that net income from certain activities that would otherwise be treated as passive income must be recharacterized as nonpassive income for purposes of the passive activity limitations.

To allow each partner to correctly apply the passive activity limitations, the partnership must report income or loss and credits separately for each of the following types of activities and income: trade or business activities, rental real estate activities, rental activities other than rental real estate, and portfolio income. For definitions of each type of activity or income, see **Types of Activities and Income,** on page 6. For details

regarding the special reporting requirements for passive activities, see **Passive Activity Reporting Requirements** on page 8.

Identifying Activities

Generally, each undertaking the partnership owns is a separate activity.

An undertaking includes all the business or rental operations owned by the partnership at the same location. Operations not actually conducted at a fixed location are treated as conducted at the location with which they are most closely associated under all the facts and circumstances. For example, if a business sends employees from a central office to perform services at customers' homes, the operations are treated as conducted at the central office. If the partnership conducts all its business or rental operations at the same location directly or through one entity, the partnership has only one undertaking and one activity.

Rental undertakings.—If the partnership owns an undertaking that conducts both rental and nonrental operations, it must treat the two types of operations as two separate undertakings unless: (1) the rental operations, if treated as a separate activity, would not be a rental activity (see **Rental Activities** below; or (2) one type of operation produces more than 80% of the combined undertaking's gross income.

Combining partnership undertakings into activities.—Once partnership undertakings are identified, treat each undertaking as a separate activity unless one of the following rules requires or permits the partnership to combine undertakings into a larger activity:

1. Trade or business undertakings.—Generally, the partnership must combine trade or business undertakings into a larger activity if the undertakings are similar and commonly controlled. For details, see Temporary Regulations section 1.469-4T(f) and (j). Trade or business undertakings include all nonrental undertakings except professional service undertakings (described in the next paragraph) and oil or gas wells treated as separate undertakings under Temporary Regulations section 1.469-4T(e). Trade or business activities that constitute an integrated business may have to be combined into an even larger activity under Temporary Regulations section 1.469-4T(g).

2. Professional service undertakings.—Professional service undertakings principally provide services in the fields of health, law, engineering, architecture, accounting, actuarial science, the performing arts, or consulting. Generally, the partnership must combine its interests in professional service undertakings into a single activity if the undertakings provide services in the same field or earn more than 20% of their gross income from serving the same customers, or if the undertakings are controlled by the same interests. For details, see Temporary Regulations section 1.469-4T(h).

The partnership may elect to treat combined nonrental undertakings acquired in 1990 as separate activities for purposes other than determining participation in activities. To make this election, the partnership must attach to Form 1065 a statement that: **(a)** gives the partnership's name, address, and employer identification number; **(b)** declares that the election is being made under Temporary Regulations section 1.469-4T(o); **(c)** identifies the undertaking that is treated as a separate activity; and **(d)** identifies the rest of the activity from which the undertaking was separated.

If the partnership wants to treat as separate activities any undertakings it acquired in 1990 that these rules would otherwise combine into a larger activity, it must attach this statement to its 1990 return or it will not be able to treat the undertakings as separate activities for 1990 or any later year. For details, see Temporary Regulations section 1.469-4T(o).

If undertakings the partnership owned in 1989 were combined into a larger activity on its 1989 return, those undertakings cannot be divided into separate activities in 1990 or any later year.

3. Rental real estate undertakings.—A rental real estate undertaking is a rental undertaking in which at least 85% of the unadjusted basis of the property made available for use by customers is real property. The partnership may treat a single rental real estate undertaking as a single activity, or it may treat any combination of rental real estate undertakings as a single activity. Under certain circumstances, the partnership may also elect to divide a single rental real estate undertaking into separate undertakings. For details, see Temporary Regulations section 1.469-4T(k)(2)(iii).

Generally, the partnership must attach a statement to Form 1065 if it combines separate rental real estate undertakings or portions of undertakings into the same activity or divides a single rental real estate undertaking into separate undertakings. If the partnership wants to divide a single rental real estate undertaking it acquired in 1990 into separate undertakings, it must attach this statement to its 1990 return or it will not be able to treat the undertaking as separate undertakings for 1990 or any later year.

If the partnership divided a single rental real estate undertaking it owned in 1989 into separate undertakings on its 1989 return, it must treat the undertakings as separate undertakings in 1990 and any later year.

Furthermore, if the partnership combined rental real estate undertakings it owned in 1989 into a larger activity on its 1989 return, the larger activity cannot be divided into separate activities in 1990 or any later year.

Types of Activities and Income

1. Trade or business activities.—A trade or business activity is an activity that involves the conduct of a trade or business within the meaning of section 162.

If the partner does not materially participate in the activity, a trade or business activity held through a partnership is generally a passive activity of the partner. However, the passive activity limitations do not apply to any partner holding a working interest in an oil or gas well if the partner holds the interest through an entity that does not limit the partner's liability. See Temporary Regulations section 1.469-1T(e)(4) for more information.

The determination whether a partner materially participated in an activity must be made by each partner. As a result, while the partnership's overall trade or business income (loss) is reported on page 1 of Form 1065, the specific income and deductions from each separate trade or business activity must be reported on attachments to Form 1065. Similarly, while each partner's allocable share of the partnership's overall trade or business income (loss) is reported on line 1 of Schedule K-1, each partner's allocable share of the income and deductions from each trade or business activity must be reported on attachments to each Schedule K-1. See **Passive Activity Reporting Requirements,** on page 8, for more information.

2. Rental activities.—In reporting the partnership's income or losses and credits from rental activities, the partnership must separately report: **(a)** rental real estate activities, and **(b)** rental activities other than rental real estate activities.

Definition of rental activities.—Generally, except as noted below, if the gross income from an activity consists of amounts paid principally for the use of real or personal tangible property held by the partnership, the activity is a rental activity. There are several exceptions to this general rule. Under these exceptions, an activity involving the use of real or personal tangible property is not a rental activity if: **(a)** the average period of customer use (see definition on page 7) for such property is 7 days or less; **(b)** the average period of customer use for such property is 30 days or less and significant personal services (see definition on page 7) are provided by or on behalf of the partnership; **(c)** extraordinary personal services (see definition on page 7) are provided by or on behalf of the partnership; **(d)** the rental of such property is treated as incidental to a nonrental activity of the partnership under Temporary Regulations section 1.469-1T(e)(3)(vi); or **(e)** the partnership customarily makes the property available during defined business hours for nonexclusive use by various customers.

In addition, if a partnership owns an interest in a partnership or joint venture that conducts a nonrental activity, and the partnership provides property for use in that nonrental activity in the partnership's capacity as an owner of an interest in the partnership or joint venture, the provision of the property is not a rental activity. Consequently, the partnership's distributive share of income from the activity is not income from a rental activity. A guaranteed payment described in section 707(c) is not income from a

rental activity under any circumstances. Whether the partnership provides property used in an activity of another partnership or of a joint venture in the partnership's capacity as an owner of an interest in the partnership or joint venture is determined on the basis of all of the facts and circumstances.

Average period of customer use.—The average period of customer use for a class of property is computed by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by the ratio of the gross rental income from that class to the activity's total gross rental income. The activity's average period of customer use equals the sum of these class-by-class average periods weighted by gross income. See Temporary Regulations section 1.469-1T(e)(3)(iii).

Significant personal services.—Personal services include only services performed by individuals. In determining whether personal services are significant personal services, all the relevant facts and circumstances are taken into consideration. Relevant facts and circumstances include the frequency with which the services are provided, the type and amount of labor required to perform the services, and the value of the services in relation to the amount charged for use of the property. The following services are excluded from consideration in determining whether personal services are significant: **(a)** services necessary to permit the lawful use of the rental property; **(b)** services performed in connection with improvements or repairs to the rental property that extend the useful life of the property substantially beyond the average rental period; **(c)** services provided in connection with the use of any improved real property that are similar to those commonly provided in connection with long-term rentals of high-grade commercial or residential property (e.g., cleaning and maintenance of common areas, routine repairs, trash collection, elevator service, and security at entrances).

Extraordinary personal services.—Services provided in connection with making rental property available for customer use are extraordinary personal services only if the services are performed by individuals and the customers' use of the rental property is incidental to their receipt of the services. For example, a patient's use of a hospital room generally is incidental to the care received from the hospital's medical staff. Similarly, a student's use of a dormitory room in a boarding school is incidental to the personal services provided by the school's teaching staff.

Rental activity incidental to a nonrental activity.—An activity is not a rental activity if the rental of the property is incidental to a nonrental activity, such as the activity of holding property for investment, a trade or business activity, or the activity of dealing in property.

Rental of property is incidental to an activity of holding property for investment if the main purpose for holding the property is to realize a gain from the appreciation of the property and the gross rental income from such property for the tax year is less than 2% of the smaller of the unadjusted basis of the property or the fair market value of the property.

Rental of property is incidental to a trade or business activity if: **(a)** the partnership owns an interest in the trade or business at all times during the year; **(b)** the rental property was mainly used in the trade or business activity during the tax year or during at least 2 of the 5 preceding tax years; and **(c)** the gross rental income from the property for the tax year is less than 2% of the smaller of the unadjusted basis of the property or the fair market value of the property.

The sale or exchange of property that is both rented and sold or exchanged during the tax year (where the gain or loss is recognized) is treated as incidental to the activity of dealing in property if, at the time of the sale or exchange, the property was held primarily for sale to customers in the ordinary course of the partnership's trade or business.

See Temporary Regulations section 1.469-1T(e)(3) for more information on the definition of rental activities for purposes of the passive activity limitations.

2(a). Rental real estate activities.—Partners who actively participate in a rental real estate activity may be able to deduct part or all of their rental real estate losses (and the deduction equivalent of rental real estate credits) against income (or tax) from nonpassive activities. The combined amount of rental real estate losses and the deduction equivalent of rental real estate credits from all sources (including rental real estate activities not held through the partnership) that may be claimed is limited to $25,000. This $25,000 amount is reduced for high income partners.

Special transitional rules apply to investors in qualified low-income housing projects. See section 502 of the 1986 Act and **Pub. 925,** Passive Activity and At-Risk Rules, for more information.

Rental real estate activity income (loss) is reported on **Form 8825,** Rental Real Estate Income and Expenses of a Partnership or an S Corporation, and line 2 of Schedules K and K-1 rather than on page 1 of Form 1065.

Credits related to rental real estate activities are reported on lines 13c and 13d of Schedules K and K-1. Low-income housing credits are reported on line 13b of Schedules K and K-1.

2(b). Rental activities other than rental real estate activities.— Income (loss) from rental activities other than rental real estate is reported on line 3 of Schedules K and K-1. Credits related to rental activities other than rental real estate are reported on line 13e of Schedules K and K-1.

3. Portfolio income.—Generally, portfolio income includes all gross income, other than income derived in the ordinary course of a trade or business, that is attributable to: interest; dividends; royalties; income from a real estate investment trust, a regulated investment company, a real estate mortgage investment conduit, a common trust fund, a controlled foreign corporation, a qualified electing fund, or a cooperative; income from the disposition of property that produces income of a type defined as portfolio income; and income from the disposition of property held for investment.

Solely for purposes of the preceding paragraph, gross income derived in the ordinary course of a trade or business includes (and portfolio income, therefore, does not include) only the following types of income: **(a)** interest income on loans and investments made in the ordinary course of a trade or business of lending money; **(b)** interest on accounts receivable arising from the performance of services or the sale of property in the ordinary course of a trade or business of performing such services or selling such property, but only if credit is customarily offered to customers of the business; **(c)** income from investments made in the ordinary course of a trade or business of furnishing insurance or annuity contracts or reinsuring risks underwritten by insurance companies; **(d)** income or gain derived in the ordinary course of an activity of trading or dealing in any property if such activity constitutes a trade or business (unless the dealer held the property for investment at any time before such income or gain is recognized); **(e)** royalties derived by the taxpayer in the ordinary course of a trade or business of licensing intangible property; **(f)** amounts included in the gross income of a patron of a cooperative by reason of any payment or allocation to the patron based on patronage occurring with respect to a trade or business of the patron; and **(g)** other income identified by the Commissioner as income derived by the taxpayer in the ordinary course of a trade or business.

See Temporary Regulations section 1.469-2T(c)(3) for more information on portfolio income.

Portfolio income is reported on line 4 of Schedules K and K-1, rather than on page 1 of Form 1065.

Deductions related to portfolio income are reported on line 10 of Schedules K and K-1.

Recharacterization of Passive Income

Under the provisions of Temporary Regulations section 1.469-2T(f), net passive income from certain passive activities must be treated as nonpassive income. Income from the following sources is subject to recharacterization: **(1)** significant participation passive activities, **(2)** rental of substantially nondepreciable property, **(3)** passive equity-financed lending activities, **(4)** rental of property incidental to a development activity, **(5)** rental of property to a nonpassive activity, and **(6)**

acquisition of an interest in a passthrough entity that licenses intangible property.

Any net passive income from the rental of substantially nondepreciable property, from an equity-financed lending activity, or from an activity related to an interest in a passthrough entity that licenses intangible property that is recharacterized as nonpassive income is treated by partners as investment income for purposes of computing investment interest expense limitations. "Net passive income" means the excess of passive activity gross income from the activity over passive activity deductions (current year deductions and prior year unallowed losses) from the activity.

1. Significant participation passive activities.—A significant participation passive activity is any trade or business activity in which the partner both participates for more than 100 hours during the tax year and does not materially participate. Because each partner must determine the partner's level of participation, the partnership will not be able to identify significant participation passive activities.

2. Certain nondepreciable rental property activities.—Net passive income from a rental activity is nonpassive income if less than 30% of the unadjusted basis of the property used or held for use by customers in the activity is subject to depreciation under section 167.

3. Passive equity-financed lending activities.—If the partnership has net income from a passive equity-financed lending activity, the lesser of the net passive income or the equity-financed interest income from the activity is nonpassive income.

Note: *The amount of income from the activities in items 1 through 3 above, that any partner will be required to recharacterize as nonpassive income may be limited under Temporary Regulations section 1.469-2T(f)(8). Since the partnership will not have information regarding all of a partner's activities, it must identify all partnership activities meeting the definitions in items 2 and 3 as activities that may be subject to recharacterization.*

4. Rental of property incidental to a development activity.—Net rental activity income is nonpassive income for a partner if all of the following apply: **(a)** the partnership recognizes gain from the sale, exchange, or other disposition of the rental property during the tax year; **(b)** the use of the item of property in the rental activity started less than 12 months before the date of disposition (the use of an item of rental property begins when substantially all of the property is first held out for rent and is in a state of readiness for rental); and **(c)** the partner materially participated or significantly participated for any tax year in an activity that involved the performance of services for the purpose of enhancing the value of the property (or any other item of property, if the basis of the property disposed of is determined in whole or in part by reference to the basis of that item of property). "Net rental activity income" means the excess of passive activity gross income from renting or disposing of property over passive activity deductions (current year deductions and prior year unallowed losses) that are reasonably allocable to the rented property.

Because the partnership cannot determine a partner's level of participation, the partnership must identify net income from property described in items (a) and (b) of paragraph 4 as income that may be subject to recharacterization.

5. Rental of property to a nonpassive activity.—If a taxpayer rents property to a trade or business activity in which the taxpayer materially participates, the taxpayer's net rental activity income from the property is nonpassive income. "Net rental activity income" means the excess of passive activity gross income from renting or disposing of property over passive activity deductions (current year deductions and prior year unallowed losses) that are reasonably allocable to the rented property.

6. Acquisition of an interest in a passthrough entity that licenses intangible property.—Generally, net royalty income from intangible property is nonpassive income if the taxpayer acquired an interest in the passthrough entity after the passthrough entity created the intangible property or performed substantial services, or incurred substantial costs in developing or marketing the intangible property. "Net royalty income" means the excess of passive activity gross income from licensing or transferring any right in intangible property over passive activity deductions (current year deductions and prior year unallowed losses) that are reasonably allocable to the intangible property.

See Temporary Regulations section 1.469-2T(f)(7)(iii) for exceptions to this rule.

Passive Activity Reporting Requirements

To allow partners to correctly apply the passive activity loss and credit rules, any partnership that carries on more than one activity must:

1. Provide an attachment for each activity conducted through the partnership that identifies the type of activity conducted (trade or business, rental real estate, rental activity other than rental real estate, or investment).

2. On the attachment for each activity, provide a schedule, using the same line numbers as shown on Schedule K-1, detailing the net income (loss), credits, and all items required to be separately stated under section 702(a) from each trade or business activity, from each rental real estate activity, from each rental activity other than a rental real estate activity, and from investments. With respect to each separately identified activity, identify any activity that both is a pre-enactment activity conducted through the partnership and relates to a pre-enactment interest of the partner.

3. Identify the net income (loss) and credits from each oil or gas well drilled or operated pursuant to a working interest that any partner (other than a partner whose only interest in the partnership during the year is as a limited partner) holds through the partnership. Further, if any partner had an interest as a general partner in the partnership during less than the entire year, the partnership must identify both the disqualified deductions from each well that the partner must treat as passive activity deductions, and the ratable portion of the gross income from each well that the partner must treat as passive activity gross income.

4. Identify the net income (loss) and the partner's share of partnership interest expense from each activity of renting a dwelling unit that the partner also uses for personal purposes during the year for more than the greater of 14 days or 10% of the number of days that the residence is rented at fair rental value.

5. Identify the net income (loss) and the partner's share of partnership interest expense from each activity of trading personal property conducted through the partnership.

6. With respect to any gain (loss) from the disposition of an interest in an activity or of an interest in property used in an activity (including dispositions before 1987 from which gain is being recognized after 1986):

(a) identify the activity in which the property was used at the time of disposition;

(b) if the property was used in more than one activity during the 12 months preceding the disposition, identify the activities in which the property was used and the adjusted basis allocated to each activity; and,

(c) with respect to gains only, if the property was substantially appreciated at the time of the disposition and the applicable holding period specified in Temporary Regulations section 1.469-2T(c)(2)(iii)(A) was not satisfied, identify the amount of the nonpassive gain and indicate whether or not the gain is investment income under the provisions of Temporary Regulations section 1.469-2T(c)(2)(iii)(E).

7. Specify the amount of gross portfolio income, the interest expense properly allocable to portfolio income, and expenses other than interest expense that are clearly and directly allocable to portfolio income.

8. Identify separately any of the following types of payments to partners: payments to a partner for services other than in the partner's capacity as a partner (under section 707(a)); guaranteed payments to a partner for services (under section 707(c)); guaranteed payments for use of capital; if section 736(a)(2) payments are made for unrealized receivables or for goodwill, the amount of the payments and the activities to which the payments are attributable; if section 736(b) payments are made, the amount of the payments and the activities to which the payments are attributable.

9. Identify the ratable portion of any section 481 adjustment (whether a net positive or a net negative adjustment) allocable to each partnership activity.

10. Identify the amount of gross income from each oil or gas property of the partnership.

11. Identify any gross income from sources that are specifically excluded from passive activity gross income, including: income from intangible property if the partner is an individual and the partner's personal efforts significantly contributed to the creation of the property; income from a qualified low-income housing project (as defined in section 502 of the 1986 Act) conducted through the partnership; income from state, local, or foreign income tax refunds; and income from a covenant not to compete (in the case of a partner who is an individual and who contributed the covenant to the partnership).

12. Identify any deductions that are not passive activity deductions.

13. If the partnership makes a full or partial disposition of its interest in another entity, identify the gain (loss) allocable to each activity conducted through the entity, and the gain allocable to a passive activity that would have been recharacterized as nonpassive gain had the partnership disposed of its interest in property used in the activity (because the property was substantially appreciated at the time of the disposition, and the gain represented more than 10% of the partner's total gain from the disposition).

14. Identify the following items with respect to activities that may be subject to the recharacterization rules under Temporary Regulations section 1.469-2T(f):

(a) net income from an activity of renting substantially nondepreciable property;

(b) the lesser of equity-financed interest income or net passive income from an equity-financed lending activity;

(c) net rental activity income from property that was developed (by the partner or the partnership), rented, and sold within 12 months after the rental of the property commenced;

(d) net rental activity income from the rental of property by the partnership to a trade or business activity in which the partner had an interest (either directly or indirectly); and

(e) net royalty income from intangible property if the partner acquired the partner's interest in the partnership after the partnership created the intangible property or performed substantial services, or incurred substantial costs in developing or marketing the intangible property.

15. With respect to credits, identify separately the credits from the partnership that are associated with each activity conducted by or through the partnership.

16. With respect to credits being taken on a qualified progress expenditure basis, identify the activity in which the property will be placed in service upon completion of the expenditures.

Specific Instructions

These instructions follow the line numbers on the first page of Form 1065 and on the schedules that accompany it. Specific instructions for most of the lines are provided on the following pages. Lines that are not discussed in the instructions are self-explanatory.

Fill in all applicable lines and schedules. Enter any items specially allocated to the partners on the appropriate line of the applicable partner's Schedule K-1. Enter the total amount on the appropriate line of Schedule K. Do not enter separately stated amounts on the numbered lines on Form 1065, page 1, or on Schedule A or D.

Be sure to file all three pages of Form 1065 as well as a Schedule K-1 for each partner.

File only one Form 1065 for each partnership. Mark "duplicate copy" on any copy you give to a partner.

If a syndicate, pool, joint venture, or similar group files Form 1065, a copy of the agreement and all amendments must be attached to the return, unless a copy has already been filed.

Form 1065

Name, Address, and Employer Identification Number

Use the label on the package that was mailed to the partnership. If the partnership's name, address, or employer identification number is wrong on the label, mark through it and write the correct information on the label. If the partnership does not have a package with a label, print or type the partnership's legal or trade name and address on the appropriate lines.

Address.—Include the suite, room, or other unit number after the street address. If a pre-addressed label is used, please include this information on the label.

If the Post Office does not deliver mail to the street address and the partnership has a P.O. box, show the P.O. box number instead of the street address.

If the partnership's address is outside of the United States or its possessions or territories, enter the information on the line for "City or town, state, and ZIP code" in the following order: city, province or state, foreign postal code, and the name of the foreign country. Do **not** abbreviate the country name.

Employer identification number.—Show the correct employer identification number in Item D on page 1 of Form 1065. If the partnership does not have an employer identification number, it must apply for one on **Form SS-4,** Application for Employer Identification Number. Form SS-4 can be obtained at any IRS or Social Security Administration office. See Pub. 583 for more information.

Item A

Principal Business Activity

Enter the applicable activity name and code number from the list on page 24.

For example, if, as its principal business activity, the partnership (1) purchases raw materials, (2) subcontracts out for labor to make a finished product from the raw materials, and (3) retains title to the goods, the partnership is considered to be a manufacturer and must enter "Manufacturer" in Item A and enter one of the codes (2000 through 3970) under "Manufacturing" on page 24 of the Instructions in Item C.

Item F

Total Assets

See the instructions below for Question N before completing Item F.

If you are required to complete this item, enter the total assets, as determined by the accounting method regularly used in maintaining the partnership's books and records, as of the end of the partnership's tax year. If there are no assets at the end of the tax year, enter the total assets as of the beginning of the tax year.

Item I

Number of Partners

Enter the total number of persons who were partners at **any time** during the tax year.

Question M

Consolidated Audit Procedures

Generally, the tax treatment of partnership items is determined at the partnership level in a consolidated audit proceeding, rather than in separate proceedings with individual partners.

Answer "Yes" to Question M if any of the following apply:

- The partnership had more than 10 partners at any one time during the tax year (for purposes of this question, a husband and wife—and their estates—count as one person); or
- Any partner was a nonresident alien or was other than a natural person or estate; or
- Any partner's share of any partnership item was different from his or her share of any other partnership item; or
- The partnership is a "small partnership" that has elected to be subject to the rules for consolidated audit proceedings.

"Small partnerships" as defined in section 6231(a)(1)(B) are not subject to the rules for consolidated audit proceedings, but may make an irrevocable election to be covered by them.

For more information on the rules for consolidated audit proceedings, see **Pub. 556,** Examination of Returns, Appeal Rights, and Claims for Refund, and section 6231.

Question N

Answer "Yes" to Question N if **ALL** of the requirements 1 through 7 on page 10 are

met. If Question N is answered "Yes," the partnership is not required to complete Schedules L and M, Item F on page 1 of Form 1065, or Item K on Schedule K-1.

1. The partnership's principal income producing activity is from one or more of the following:

a. Co-ownership of investment property.

b. Family-owned wholesale or retail store partnership (activity codes 5001–5996).

c. Family farm partnership.

d. Wholesale or retail (activity codes 5001–5996), or service (activity codes 7012–8999) partnership with **both** gross receipts and assets of less than $250,000.

See page 24 for the list of activity codes.

2. The partnership is a domestic partnership composed of 10 or fewer partners (generally, 10 or fewer Schedules K-1 are attached to this return, except that a husband and wife and their estates are treated as one partner for this purpose) each of whom is a natural person (other than a nonresident alien) or an estate.

3. The partnership does not have any trusts or corporations as partners.

4. The partnership is not a partner in any other partnership.

5. Each partner's interest in the capital is the same as his or her interest in the profits.

6. All of the income, deductions, and credits are allocated to each partner in proportion to that partner's pro rata interest.

7. Schedules K-1 are filed with the return and furnished to the partners on or before the due date of the partnership return including extensions.

Question O

Foreign Partners

Answer "Yes" to Question O if the partnership had any foreign partners (for purposes of section 1446) at any time during the tax year. Otherwise, answer "No."

If the partnership had gross income effectively connected with a trade or business in the U.S. and foreign partners, it may be required to withhold tax under section 1446 on income allocable to foreign partners (without regard to distributions) and file Forms 8804, 8805, and 8813. See Revenue Procedure 89-31, 1989-1 C.B. 895, for more information.

Question R

Section 754 Election

Under section 754, a partnership may elect to adjust the basis of partnership property when property is distributed or when a partnership interest is transferred. If the election is made with respect to a transfer of a partnership interest (section 743(b)) and the assets of the partnership constitute a trade or business for purposes of section 1060(c), then the value of any goodwill transferred must be determined in the manner provided in Temporary Regulations section 1.1060-1T. Once an election is made under section 754, it applies both to all distributions and to all transfers made during the tax year and in all subsequent tax years unless the election is revoked (see Regulations section 1.754-1(c)).

This election must be made in a statement that is filed with the partnership's timely filed return (including any extension) for the tax year during which the distribution or transfer occurs. The statement must include: (1) the name and address of the partnership; (2) a declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b); and (3) the signature of the general partner authorized to sign the partnership return.

See section 754 and the related regulations for more information.

Note: *If there is a distribution of property consisting of an interest in another partnership, see section 734(b).*

Question S

Foreign Accounts

Answer "Yes" to Question S if either a OR b below applies to the partnership:

a At any time during the year, the partnership had an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country.

Exception: Answer "No" if either of the following applies to the partnership:

- The combined value of the accounts was $10,000 or less during the whole year.
- The accounts were with a U.S. military banking facility operated by a U.S. financial institution.

b. The partnership owns more than 50% of the stock in any corporation that would answer the question "Yes," based on item a above.

Get form **TD F 90-22.1,** Report of Foreign Bank and Financial Accounts, to see if the partnership is considered to have an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country.

If you answered "Yes" to Question S, file form TD F 90-22.1 by June 30, 1991. File it with the Department of the Treasury at the address shown on the form. Form TD F 90-22.1 is not a tax return. Do not file it with Form 1065.

Attach a statement that gives the names of the country or countries to which Question S applies if you need additional space to write in their names.

Income

Lines 1a through 8

Caution: *Report only trade or business activity income on lines 1a through 8.* ***Do not report rental activity income or portfolio income on these lines.*** *(See the instructions on* ***Passive Activity Limitations*** *beginning on page 5 for definitions of rental income and portfolio income.) Rental activity income and portfolio income are reported on Schedules K and K-1 (rental real estate activities are also reported on Form 8825).*

Do not include any income that is tax exempt on lines 1a through 8.

A partnership that receives any tax-exempt income other than interest, or holds any property or engages in any activity that produces tax-exempt income, must attach to its return an itemized statement showing the amount of each type of tax-exempt income, and the amount of expense allocated to each type.

Tax-exempt interest income, including exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company, is reported to the partners on line 21 of Schedule K-1.

See the instructions for **Deductions** on page 11 for information on how to treat expenses related to tax-exempt income.

If the partnership has been involved in bankruptcy, insolvency, or similar proceedings, see section 108, **Form 982,** Reduction of Tax Attributes Due to Discharge of Indebtedness, and **Pub. 908,** Bankruptcy and Other Debt Cancellation, for more information.

Line 1a

Gross Receipts or Sales

Enter gross receipts or sales from all trade or business operations. Do not include rental activity income or portfolio income. Also, do not include income you are required to report on lines 4 through 7. For example, do not include gross receipts from farming on this line. Instead, show net profits (losses) from farming on line 5.

Special rules apply to long-term contracts. See section 460 for more information.

Generally, the installment method cannot be used for dealer dispositions of property. A "dealer disposition" means any disposition of personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan or any disposition of real property held for sale to customers in the ordinary course of the taxpayer's trade or business. The disposition of property used or produced in a farming business is not included as a dealer disposition. See section 453(l) for details and exceptions.

For dealer dispositions of property before March 1, 1986, dispositions of property used or produced in the trade or business of farming, and certain dispositions of timeshares and residential lots reported under the installment method, enter on line 1a the gross profit on collections from installment sales and carry the same amount to line 3. Attach a schedule showing the following for the current year and the three preceding years: **(a)** gross sales, **(b)** cost of goods sold, **(c)** gross profits, **(d)** percentage of gross profits to gross sales, **(e)** amount collected, and **(f)** gross profit on amount collected.

Line 2

Cost of Goods Sold

See the instructions for Schedule A.

Line 4

Ordinary Income (Loss) From Other Partnerships and Fiduciaries

Enter the amount shown on Schedule K-1 (Form 1065) or Schedule K-1 (Form 1041).

Do **not** include portfolio income or rental activity income (loss) from other partnerships and fiduciaries on this line. Instead, report these amounts on the applicable lines of Schedules K and K-1, or on line 20a of Form 8825 if the amount is from a rental real estate activity.

Treat shares of other items separately reported on Schedule K-1 issued by the other entity as if the items were realized or incurred by this partnership.

Note: *Partnerships must consider the rules of section 469 (including the rules regarding publicly traded partnerships) when reporting items from other partnerships or fiduciaries in which they are partners or beneficiaries. For example, portfolio income from other partnerships or fiduciaries must be reported as a separately stated item to partners in this partnership and should not be reported on page 1 of Form 1065.*

If there is a loss from another partnership, the amount of the loss that may be claimed is subject to the limitations of sections 465 and 704(d), as appropriate.

If the tax year of your partnership does not coincide with the tax year of the other partnership or fiduciary, include the ordinary income (loss) from the other entity in the tax year in which the other entity's tax year ends.

Note: *Be sure to show the partnership's or fiduciary's name, address, and employer identification number on a separate statement attached to this return. If the amount entered is from more than one source, identify the amount from each source.*

Line 5

Net Farm Profit (Loss)

Enter the partnership's net profit (loss) from **Schedule F (Form 1040)**, Farm Income and Expenses. Attach Schedule F (Form 1040) to Form 1065. Do **not** include on this line any farm profit (loss) from other partnerships. Report those amounts on line 4. In computing the partnership's net farm profit (loss) do not include any section 179 expense deduction, since this amount must be separately stated.

Also report the partnership's fishing income on this line.

A special rule applies to farm partnerships that use the cash method of accounting, and whose prepaid expenses for feed, seed, fertilizer, other farm supplies, and the cost of poultry are more than 50% of other deductible farming expenses. Generally, any such excess may be deducted only in the year the items are actually used or consumed. See section 464(f).

Farm syndicates (section 464(c)) are required to use the accrual method of accounting. See section 448.

If a corporation is a partner of a partnership engaged in farming, see section 447.

For more information, see **Pub. 225**, Farmer's Tax Guide.

Note: *For partnerships not required to use the accrual method of accounting, the rules of section 263A do **not** apply to expenses of raising: **(a)** any animal or **(b)** any plant that has a preproductive period of two years or less. Partners of partnerships not required to use the accrual method of accounting may elect to currently deduct the preproductive period expenses of certain plants that have a preproductive period of more than two years. Because the election to deduct these expenses is made by the partner, farm partnerships that are not required to use an accrual method should not capitalize such preproductive period expenses but should instead state them separately on an attachment to Schedule K, line 19, and on Schedule K-1, line 21, item h. See Temporary Regulations section 1.263A-1T(c) for more information.*

Line 6

Net Gain (Loss) From Form 4797

Caution: *Include only ordinary gains or losses from the sale, exchange, or involuntary conversion of assets used in a trade or business activity. Ordinary gains or losses from the sale, exchange, or involuntary conversion of rental activity assets will be reported separately on line 19 of Form 8825 or line 3 of Schedules K and K-1, generally as a part of the net income (loss) from the rental activity.*

In addition to other ordinary gains or losses shown on **Form 4797**, Sales of Business Property, and reported on line 6, a partnership that is a partner in another partnership must include on Form 4797 its share of ordinary gains (losses) from sales, exchanges, or involuntary conversions (other than casualties or thefts) of the other partnership's trade or business assets.

Do not include any recapture of expense deduction for recovery property (section 179). See the instructions for Schedule K-1, line 21, item e, and the Instructions for Form 4797 for more information.

Line 7

Other Income (Loss)

Enter on line 7 trade or business income (loss) that is not included on lines 1a through 6. Examples of such income include: **(1)** interest income derived in the ordinary course of the partnership's trade or business, such as interest charged on receivable balances; **(2)** recoveries of bad debts deducted in earlier years under the specific charge-off method; **(3)** taxable income from insurance proceeds; and **(4)** the amount of credit figured on **Form 6478, Credit for Alcohol Used as Fuel.** Also include on line 7 all section 481 income adjustments resulting from changes in accounting methods. Specific examples of section 481 adjustments that may be required include those that result from: **(1)** a required change from the reserve method to the specific charge-off method of accounting for bad debts; **(2)** a required change from the reserve method of accounting for vacation pay; and **(3)** a required change to the capitalization of past service pension costs under the uniform capitalization rules of section 263A. Show the computation of the section 481 adjustments on an attached schedule.

Do not include items requiring separate computations that must be reported on Schedules K and K-1. See the Instructions for Schedules K and K-1 later in these instructions.

The partnership must include as other income the recapture amount for section 280F if the business use of listed property drops to 50% or less. See section 280F(b)(3). To figure the recapture amount, the partnership must complete Part V of Form 4797.

Do not report portfolio or rental activity income (loss) on this line.

Deductions

Lines 9a through 20

Caution: *Report only trade or business activity deductions on lines 9a through 20. **Do not report rental activity expenses or deductions allocable to portfolio income on these lines.** Rental activity expenses are separately reported on Form 8825 or line 3 of Schedules K and K-1. Deductions allocable to portfolio income are separately reported on line 10 of Schedules K and K-1. See the instructions on **Passive Activity Limitations** beginning on page 5 for more information on rental activities and portfolio income.*

Do not report any nondeductible amounts (such as expenses connected with the production of tax-exempt income) on lines 9a through 20. If an expense is connected with both taxable income and nontaxable income, allocate a reasonable part of the expense to each kind of income. (See section 265.)

Do not take a deduction for any qualified expenditures to which an election under section 59(e) may apply. See the instructions for Schedules K and K-1, lines 18a and 18b, for information on how to report these amounts.

Do not deduct in this section items which section 702 and the regulations require that the partnership state separately and which require separate computations by the partners. For example, section 212 expenses incurred for the production of income instead of in a trade or business must be separately stated. Other items which must be separately stated include charitable contributions, foreign taxes paid, intangible drilling and development costs, soil and water conservation expenditures, and exploration expenditures. The distributive shares of these expenses are

reported as separate items to each partner on Schedule K-1.

Limitations on Deductions

a. Section 263A Uniform Capitalization Rules.—The uniform capitalization rules of section 263A require partnerships to capitalize or include in inventory certain costs incurred in connection with the production of real and personal tangible property held in inventory or held for sale in the ordinary course of business. Tangible personal property produced by a partnership includes a film, sound recording, video tape, book, or similar property. The rules also apply to personal property (tangible and intangible) acquired for resale. Partnerships subject to the rules are required to capitalize not only direct costs but an allocable portion of most indirect costs (including taxes) that benefit the assets produced or acquired for resale. Interest expense paid or incurred during the production period of certain property must be capitalized and is governed by special rules. For more information, see Notice 88-99, 1988-2 C.B. 422. The uniform capitalization rules also apply to the production of property constructed or improved by a partnership for use in its trade or business or in an activity engaged in for profit.

Section 263A does not apply to personal property acquired for resale if the taxpayer's annual average gross receipts are $10 million or less. It does not apply to timber or to most property produced under a long-term contract. Special rules apply to certain partnerships engaged in farming (see the note at the end of line 5 instructions). The rules do not apply to property which is produced for use by the taxpayer if substantial construction occurred before March 1, 1986.

In the case of inventory, some of the indirect expenses that must be capitalized are: administration expenses; taxes; depreciation; insurance; compensation paid to officers attributable to services; rework labor; and contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

The costs required to be capitalized under section 263A are not deductible until the property to which the costs relate is sold, used, or otherwise disposed of by the partnership.

Research and experimental costs under section 174, intangible drilling costs for oil and gas and geothermal property, and mining exploration and development costs are reported separately to partners for purposes of determinations under section 59(e). Temporary Regulations section 1.263A-1T specifies other indirect costs that may be currently deducted and those that must be capitalized with respect to production or resale activities. For more information, see Temporary Regulations section 1.263A-1T; Notice 88-86, 1988-2 C.B. 401; and Notice 89-67, 1989-1 C.B. 723.

b. Transactions Between Related Taxpayers.—Generally, an accrual basis partnership may deduct business expenses and interest owed to a related party (including any partner) only in the tax year of the partnership that includes the day on which the payment is includible in the income of the related party. See section 267 for details.

c. Business Start-up Expenses.—Business start-up expenses are required to be capitalized unless an election is made to amortize them over a period of not less than 60 months. See section 195.

d. Organization and Syndication Fees.—Amounts paid or incurred to organize a partnership or promote the sale of an interest in a partnership are capital expenditures. They are not deductible as a current expense.

Under section 709, the partnership may elect to amortize organization expenses over a period of 60 or more months, beginning with the month in which the partnership begins business. (Include the amortization expense on line 19.) On the balance sheet (Schedule L) show the unamortized balance of organization costs and all syndication expenditures. See the instructions for line 10 for the treatment of organization and syndication expenses paid to a partner.

Syndication costs incurred in connection with the sale of limited partnership interests are capital expenditures and cannot be amortized by the partnership. See Revenue Ruling 85-32, 1985-1 C.B. 186.

e. Research Expenses.—Deductions under section 174 or any other provision for research expenses or basic research payments must be reduced by 50% of the partnership's research credit determined for the year, unless an election is made to have the research credit not apply. A similar rule applies where the partnership capitalizes, rather than expenses, qualified research expenses.

Line 9a

Salaries and Wages

Enter on line 9a the amount of salaries and wages paid or incurred for the tax year. Do not include salaries and wages reported elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

Line 9b

Jobs Credit

Enter the total amount of the jobs credit computed by the partnership. Subtract this from the salaries and wages shown on line 9a. See the Instructions for **Form 5884,** Jobs Credit, to figure the amount of credit to enter on line 9b.

Line 10

Guaranteed Payments to Partners

Deduct payments or credits to a partner for services or for the use of capital if the payments or credits are determined without regard to partnership income and are allocable to a trade or business activity. Do not include any payments and credits that should be capitalized. For example, although payments or credits to a partner for services rendered in organizing or syndicating a partnership may be guaranteed payments under section 707, they are not deductible on line 10. They are capital expenditures. (However, they should be separately reported on Schedules K and K-1, line 5.) Do not include distributive shares of partnership profits. Report the guaranteed payments to the appropriate partners on Schedule K-1, line 5.

Line 11

Rent

Enter rent paid on business property used in a trade or business activity. Do not deduct rent for a dwelling unit occupied by any partner for personal use.

If the partnership rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred in the trade or business activities of the partnership. Also complete Part V of **Form 4562,** Depreciation and Amortization. If the partnership leased a vehicle for a term of 30 days or more, the deduction for vehicle lease expense may have to be reduced by an amount called the **inclusion amount.** You may have an inclusion amount if—

The lease term began:	And the vehicle's fair market value on the first day of the lease exceeded:
After 12/31/86	$12,800
After 4/2/85 but before 1/1/87	$23,000
After 6/18/84 but before 4/3/85	$34,500

Note: *If the partnership leased a vehicle during 1986, and the tax year beginning in 1990 is the first tax year the vehicle was used 50% or less for business, you will need to figure an additional inclusion amount. You must figure this additional amount even if the partnership had no inclusion amount using the table shown above.*

See **Pub. 917,** Business Use of a Car, for instructions on how to figure the inclusion amount and additional inclusion amount.

Line 12

Interest

Include only interest incurred in the trade or business activities of the partnership that is not claimed elsewhere on the return.

Do not include interest expense on debt required to be allocated to the production of qualified property. Interest that is allocable to certain property produced by a partnership for its own use or for sale must be capitalized. In addition, a partnership must also capitalize any interest on debt that is allocable to an asset used to produce the above property. A partner may have to capitalize interest that the partner incurs during the tax year with respect to the production expenditures of the partnership. Similarly, interest incurred by a partnership may have to be capitalized by a partner with respect to the partner's own production expenditures. The information required by the partner to properly capitalize interest

for this purpose must be provided by the partnership in an attachment to Schedule K-1. See section 263A(f) and Notice 88-99, 1988-2 C.B. 422.

Do not include interest expense on debt used to purchase rental property or debt used in a rental activity. Interest allocable to a rental real estate activity is reported on Form 8825 and is used in arriving at net income (loss) from rental real estate activities on line 2 of Schedules K and K-1. Interest allocable to a rental activity other than a rental real estate activity is included on line 3b of Schedule K and is used in arriving at net income (loss) from a rental activity (other than a rental real estate activity). This net amount is reported on line 3c of Schedule K and line 3 of Schedule K-1.

Do not include interest expense on debt used to buy property held for investment. Do not include interest expense that is clearly and directly allocable to interest, dividend, royalty, or annuity income not derived in the ordinary course of a trade or business. Interest paid or incurred on debt used to purchase or carry investment property is reported on line 12a of Schedules K and K-1. See the instructions for line 12a of Schedules K and K-1 and Form 4952 for more information on investment property.

Do not include interest on debt proceeds allocated to distributions made to partners during the tax year. Instead, report such interest on line 11 of Schedules K and K-1. To determine the amount to allocate to distributions to partners, see Notice 89-35, 1989-1 C.B. 675.

Temporary Regulations section 1.163-8T gives rules for allocating interest expense among activities so that the passive activity limitation (section 469), investment interest limitation, and the personal interest limitation can be properly computed. Generally, interest expense is allocated in the same manner that debt is allocated. Debt is allocated by tracing disbursements of the debt proceeds to specific expenditures, as provided in the regulations. These regulations give rules for tracing debt proceeds to expenditures.

See Temporary Regulations section 1.163-8T for special rules on the allocation of interest expense, transitional rules, and other details.

Note: *Interest paid by a partnership to a partner for the use of capital should be entered on line 10. Generally, prepaid interest can only be deducted over the period to which the prepayment applies (section 461(g)). Interest incurred during construction or improvement of real property, personal property that has a class life of 20 years or more, or other tangible property requiring more than 2 years (1 year in the case of property costing more than $1 million) to produce or construct generally must be capitalized. See section 263A for more information. The limitations on deductions for unpaid interest are in Regulations section 1.267(b)-1(b).*

Line 13

Taxes

Enter taxes paid or incurred in the trade or business activities of the partnership, if not reflected in cost of goods sold. Federal import duties and Federal excise and stamp taxes are deductible only if paid or incurred in carrying on the trade or business of the partnership.

Do not deduct taxes, including state and local sales tax paid or accrued in connection with the acquisition or disposition of business property. These taxes must be added to the cost of the property, or, in the case of a disposition, subtracted from the amount realized. See section 164.

Do not deduct taxes assessed against local benefits to the extent that they increase the value of the property assessed (such as for paving, etc.), Federal income taxes, estate, inheritance, legacy, succession, and gift taxes, or taxes reported elsewhere on the return.

Do not deduct section 901 foreign taxes. Report these taxes separately on Schedules K and K-1, line 17e.

Do not report on line 13 taxes allocable to portfolio income or to a rental activity. Taxes allocable to a rental real estate activity are reported on Form 8825. Taxes allocable to a rental activity other than a rental real estate activity are reported on line 3b of Schedule K. Taxes allocable to portfolio income are reported on line 10 of Schedules K and K-1.

See section 263A(a) for rules on capitalization of allocable costs (including taxes) for any property.

Line 14

Bad Debts

Enter the total debts that became worthless in whole or in part during the year, but only to the extent such debts relate to a trade or business activity.

Caution: *Cash method taxpayers cannot take a bad debt deduction unless the amount was previously included in income.*

Line 15

Repairs

Enter the cost of incidental repairs that do not add to the value of the property or appreciably prolong its life, but only to the extent that such repairs relate to a trade or business activity and are not claimed elsewhere on the return. New buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They are chargeable to capital accounts and may be depreciated or amortized.

Line 16

Depreciation

On line 16a enter **only** the depreciation claimed on assets used in a trade or business activity. Enter on line 16b the depreciation reported elsewhere on the return (e.g., on Schedule A) that is attributable to assets used in trade or business activities. See the Instructions for Form 4562 or **Pub. 534,** Depreciation, to figure the amount of depreciation to enter on this line. For depreciation, you must complete and attach Form 4562 only if the partnership placed property in service during 1990 or claims depreciation on any car or other listed property.

Do not include any section 179 expense deduction on this line. This amount is not deducted by the partnership. Instead, it is passed through to the partners on line 9 of Schedule K-1.

Line 17

Depletion

If the partnership claims a deduction for timber depletion, complete and attach **Form T,** Forest Industries Schedules.

Caution: *Do not report depletion deductions for oil and gas properties on this line. Each partner figures depletion on oil and gas properties under section 613A(c)(7)(D). See the instructions for Schedule K-1, line 21, item c, for the information on oil and gas depletion that must be supplied to the partners by the partnership.*

Line 18a

Retirement Plans, etc.

Do not deduct payments for partners to retirement or deferred compensation plans including IRAs, Keoghs, and Simplified Employee Pension (SEP) plans on this line. These amounts are reported on Schedule K-1, line 11, and are deducted by the partners on their own returns.

Enter the deductible contributions not claimed elsewhere on the return made by the partnership for its common-law employees under a qualified pension, profit-sharing, annuity, or SEP plan, and under any other deferred compensation plan.

If the partnership contributes to an Individual Retirement Arrangement (IRA) for employees, include the contribution in salaries and wages on page 1, line 9a, or Schedule A, line 3, and not on line 18a.

Employers who maintain a pension, profit-sharing, or other funded deferred compensation plan (other than a SEP), whether or not the plan is qualified under the Internal Revenue Code and whether or not a deduction is claimed for the current year, generally are required to file one of the following forms:

- **Form 5500,** Annual Return/Report of Employee Benefit Plan, for each plan with 100 or more participants.
- **Form 5500-C/R,** Return/Report of Employee Benefit Plan, for each plan with fewer than 100 participants.
- **Form 5500EZ,** Annual Return of One-Participant (Owners and Their Spouses) Pension Benefit Plan, for each plan which covers only partners or partners and their spouses.

There are penalties for not filing these forms on time.

See **Pub. 1048,** Filing Requirements for Employee Benefit Plans, for more information.

Line 18b

Employee Benefit Programs

Enter the partnership's contributions to employee benefit programs not claimed elsewhere on the return (for example, insurance, health, and welfare programs) that are not part of a pension, profit-sharing, etc., plan included on line 18a.

Do not include any deduction allowable under the provisions of section 162(l) with respect to amounts paid during the tax year for insurance which constitutes medical care for a partner, a partner's spouse, or a partner's dependents. Instead, report such amounts on Schedules K and K-1, line 11.

Line 19

Other Deductions

Enter any other allowable deductions related to a trade or business activity for which there is no separate line on page 1 of Form 1065.

A partnership is not allowed the deduction for net operating losses.

Do not include items requiring separate computation that must be reported on Schedule K-1.

Do not include qualified expenditures to which an election under section 59(e) may apply.

Include on line 19 the deduction taken for amortization. You must complete and attach Form 4562 if the partnership is claiming amortization of costs that begins during its 1990 tax year. The instructions for Form 4562 provide code section references for specific amortizable property. See Pub. 535 for more information on amortization.

Generally, the partnership can deduct only 80% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. In addition, meals must not be lavish or extravagant; a bona fide business discussion must occur during, immediately before, or immediately after the meal; and a partner or employee of the partnership must be present at the meal. See section 274(k)(2) for exceptions.

Additional limitations apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets.

Generally, a partnership can deduct all other ordinary and necessary travel and entertainment expenses paid or incurred in its trade or business. However, it cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) that is used for an activity that is usually considered entertainment, amusement, or recreation. ***(Note: The partnership may be able to deduct the expense if the amount is treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.)***

See section 274; **Pub. 463, Travel, Entertainment, and Gift Expenses**; and Pub. 917 for more details.

Schedule A

Cost of Goods Sold

Section 263A Uniform Capitalization Rules.—The uniform capitalization rules of section 263A are discussed under **Limitations on Deductions** on page 12. See those instructions before completing Schedule A.

Line 2

Purchases

Show withdrawals for personal use on Schedules M and K-1 (Item K) as distributions to partners, if Schedule M and Item K on Schedules K-1 are required.

Line 4a.—An entry on this line is required only for partnerships that have elected a simplified method. In the case of partnerships that have elected the simplified production method, additional section 263A costs are generally those costs, other than interest, that were not capitalized or included in inventory costs under the taxpayer's method of accounting immediately prior to the effective date in Temporary Regulations section 1.263A-1T but that are now required to be capitalized under section 263A. Interest is to be accounted for separately. In the case of partnerships that have elected a simplified resale method, additional section 263A costs are generally those costs incurred with respect to the following categories: off-site storage or warehousing; purchasing; handling, processing, assembly, and repacking; and general and administrative costs (mixed service costs). Enter on line 4a the balance of section 263A costs paid or incurred during the tax year not included on lines 2 and 3. See Temporary Regulations section 1.263A-1T for more information.

Line 4b.—Enter on line 4b any costs paid or incurred during the tax year and not entered on lines 2 through 4a.

Line 6.—See Temporary Regulations section 1.263A-1T for more information on computing the amount of additional section 263A costs to be capitalized and added to ending inventory.

Lines 8a and 8b

Inventory Valuation Methods

Inventories can be valued at: **(1)** cost; **(2)** cost or market value (whichever is lower); or **(3)** any other method approved by the Commissioner that conforms with the provisions of the applicable regulations cited below.

Taxpayers using erroneous valuation methods must request permission to change to a method permitted for Federal tax purposes. For more information, see Regulations section 1.446-1(e)(3); Revenue Procedure 84-74, 1984-2 C.B. 736; Notice 88-78, 1988-2 C.B. 394; and Notice 89-67.

Check the methods used for valuing inventories on line 8a. Under "lower of cost or market," market generally refers to normal market conditions when there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For additional requirements, see Regulations section 1.471-4 and Notice 88-86, 1988-2 C.B. 401 (Section IV(N)).

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, shop wear, etc.) within the meaning of Regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price minus the direct cost of disposition (but not less than scrap value) if the taxpayer can establish such a price. See Regulations section 1.471-2(c) for additional requirements.

On line 8a(iv), check the box provided if the partnership used a method of inventory valuation other than those described on line 8a(i), (ii), or (iii), and attach a statement describing the method used.

If this is the first year the "Last-in First-out" (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method, attach **Form 970**, Application To Use LIFO Inventory Method, or a statement with the information required by Form 970. Also check the LIFO box on line 8b.

If you have changed or extended your inventory method to LIFO and have had to "write up" your opening inventory to cost in the year of election, report the effect of this write up as income (line 7, page 1, Form 1065) proportionately over a 3-year period that begins in the tax year you made this election.

Schedule L

Balance Sheets

Note: *Domestic partnerships with 10 or fewer partners may not have to complete Schedule L. See the instructions for Question N for the specific requirements to qualify for this exception.*

The balance sheets should agree with the partnership's books and records. Attach a statement explaining any differences. Balance sheet amounts shown on Schedule L should not be adjusted to reflect any revaluation under Regulations section 1.704-1(b)(2)(iv)(f).

Partnerships reporting to the Interstate Commerce Commission or to any national, state, municipal, or other public officer may send copies of their balance sheets prescribed by the Commission or state or municipal authorities, as of the beginning

and end of the tax year, instead of completing Schedule L. However, statements filed under this procedure must contain sufficient information to enable the IRS to reconstruct a balance sheet similar to that contained on Form 1065 without contacting the partnership during processing.

Line 5. Tax-exempt securities.— Include on this line:

(1) State and local government obligations, the interest on which is excludible from gross income under section 103(a), and

(2) Stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the partnership.

Line 18. All nonrecourse loans.— Nonrecourse loans are those liabilities of the partnership for which none of the partners have any personal liability.

See Revenue Ruling 84-5, 1984-1 C.B. 32, for information on partnerships that purchase timeshare units in a vacation home with a nonrecourse obligation before deducting any interest that accrues on the obligation.

See Revenue Ruling 84-118, 1984-2 C.B. 120, for information on a limited partner's basis when there is a partially nonrecourse note.

A limited partner's basis is not increased by a share of the limited partnership's liability when the general partner has personally guaranteed a nonrecourse loan to the partnership.

Schedule M of Form 1065 and Item K of Schedule K-1

Reconciliation of Partners' Capital Accounts

Note: *Domestic partnerships with 10 or fewer partners may not have to complete Schedule M or Item K of Schedule K-1. See the instructions for Question N for the specific requirements to qualify for this exception.*

Show what caused the changes in the partners' capital accounts during the tax year.

The beginning and ending capital accounts should agree with the partnership's books and records and the balance sheet amounts. Attach a statement explaining any differences.

Also, the amounts on Schedule M should equal the total of the amounts reported in Item K of all the partners' Schedules K-1.

Include in column (d) income reported on the partnership's books but not included in column (c). Also use column (d) to make additions to the capital account for differences between tax accounting and book accounting. Examples of amounts to be included in column (d) include tax-exempt interest, other tax-exempt income, and allowable deductions used by the partnership to figure the amount shown in column (c) but not charged against book income this year.

Include in column (e) losses and deductions reported on the partnership's books but not included in column (c). Also use column (e) to make reductions to the capital account for differences between tax accounting and book accounting. Examples of amounts to be included in column (e) include investment interest expense, deductions related to portfolio income, expenses connected with the production of tax-exempt income, charitable contributions, and income included in column (c) but not recorded in the partnership's books this year.

Include in column (f) withdrawals from inventory for personal use.

Note: *If Schedule M and Item K of Schedule K-1 are not required, see the instructions for Schedule K-1, line 21, item f.*

Designation of Tax Matters Partner (TMP)

If the partnership is subject to the rules for consolidated audit proceedings in sections 6221 through 6233, the partnership may designate a partner as the TMP for the tax year for which the return is filed by completing the **Designation of Tax Matters Partner** section on page 2 of Form 1065. See the instructions for Question M, consolidated audit procedures, to determine if the partnership is subject to these rules. The designated TMP must be a general partner and, in most cases, must also be a U.S. person. For details, see Temporary Regulations section 301.6231(a)(7)-1T.

Schedules K and K-1

Partners' Shares of Income, Credits, Deductions, Etc.

Purpose of Schedules

Schedule K (page 3 of Form 1065) is a summary schedule of all the partners' shares of the partnership's income, credits, deductions, etc. **Schedule K-1 (Form 1065)** shows each partner's separate share. One copy of each K-1 must be attached to the Form 1065 filed with the Internal Revenue Service. One copy is kept with a copy of the partnership return as a part of the partnership's records. One copy must be furnished to each partner. If a partnership interest is held by a nominee on behalf of another person, the partnership may be required to furnish Schedule K-1 to the nominee. See Temporary Regulations section 1.6031(b)-1T and 1.6031(c)-1T for more information.

Be sure to give each partner a copy of either the Partner's Instructions for Schedule K-1 (Form 1065) or specific instructions for each item reported on the partner's Schedule K-1 (Form 1065).

Note: *Instructions that apply only to line items reported on Schedule K-1 may be prepared and given to each partner in lieu of the instructions printed by IRS.*

General Instructions

Although the partnership is not subject to income tax, the partners are liable for tax on their shares of the partnership income, whether or not distributed, and must include their shares on their tax returns.

Schedules K and K-1 have the same line numbers for lines 1 through 18b.

Substitute Forms

You do not need IRS approval to use a substitute Schedule K-1 if it is an exact facsimile of the IRS schedule, or if it contains only those lines the taxpayer is required to use, and the lines have the same numbers and titles and are in the same order as on the comparable IRS Schedule K-1. In either case, your substitute schedule must include the OMB number and the Partner's Instructions for Schedule K-1 (Form 1065) or other prepared specific instructions.

Other substitute Schedules K-1 require approval. You may apply for approval of a substitute form by writing to: Internal Revenue Service, Attention: Substitute Forms Program Coordinator, R:R:R, 1111 Constitution Avenue, NW, Washington, DC 20224.

Each taxpayer's information must be on a separate sheet of paper. Therefore, all continuously printed substitutes must be separated before they are filed with the Service.

You may be subject to a penalty if you file Schedules K-1 that do not conform to the specifications of Revenue Procedure 90-8, 1990-1 C.B. 434.

How Income Is Shared Among Partners

Income (loss) is allocated to a partner only for the part of the year in which that person is a member of the partnership. The partnership will either allocate on a daily basis or divide the partnership year into segments and allocate income, loss, or special items in each segment among the persons who were partners during that segment. Partnerships that report their income on the cash basis must allocate interest expense, taxes, and any payment for services or for the use of property on a daily basis if there is any change in any partner's interest during the year. (See section 706 for more information and for information on the tax consequences of the termination of a partner's interest.)

Allocate shares of income, gain, loss, deduction, or credit among the partners according to the partnership agreement for sharing income or loss generally. If the partners agree, specific items may be allocated in a ratio different from the ratio for sharing income or loss generally. For instance, if the net income exclusive of specially allocated items is divided evenly among three partners but some special items are allocated 50% to one, 30% to another, and 20% to the third partner, report the specially allocated items on the appropriate line of the applicable partner's Schedule K-1 and the total on the appropriate line of Schedule K, instead of on the numbered lines on page 1 of Form 1065 or Schedules A or D.

If the partnership agreement does not provide for the partner's share of income,

gain, loss, deduction, or credit, or if the allocation under the agreement does not have substantial economic effect, the partner's share is determined according to the partner's interest in the partnership. Regulations under section 704(b) provide rules relating to the substantial economic effect test and to the determination of a partner's interest in the partnership.

Regulations section 1.704-1(b)(2)(ii)(b)(1) provides that an allocation of income, gain, loss, or deduction to a partner will generally have economic effect only if, throughout the full term of the partnership, the partnership agreement provides for the determination and maintenance of the partners' capital accounts in accordance with the rules under Regulations section 1.704-1(b)(2)(iv). See Regulations section 1.704-1(b)(2)(iv)(r) and Notice 88-87, 1988-2 C.B. 411, for limited safe harbor rules for partnerships operating before May 1, 1986, that did not properly maintain their capital accounts.

Note: *If a partner's interest changed during the year, see section 706(d) before determining each partner's distributive share of any item of income, gain, loss, deduction, etc.*

Specific Instructions

Schedule K Only

Schedule K must be completed by all partnerships. In order for partners to comply with the requirements of section 469, trade or business activity income (loss), rental activity income (loss), and portfolio income must be considered separately by the partner. Rental activity income (loss) and portfolio income are not reported on page 1 of Form 1065. These amounts are not combined with trade or business activity income (loss). Schedule K is used to report the totals of these (and other) amounts.

Schedule K-1 Only

Prepare and give a Schedule K-1 to each person who was a partner in the partnership at any time during the year. **Schedule K-1 must be provided to each partner on or before the day on which the partnership return is required to be filed.**

Note: *Generally, under section 6031(c) any person who holds an interest in a partnership as a nominee for another person is required to furnish to the partnership the name, address, etc., of the other person (beneficial holder of the interest).*

If a husband and wife each had an interest in the partnership, prepare a separate Schedule K-1 for each of them.

If a husband and wife held an interest together, prepare one Schedule K-1 if the two of them are considered to be one partner.

On each Schedule K-1, enter the names, addresses, and identifying numbers of the partner and partnership and the partner's distributive share of each item.

For an individual partner enter the partner's social security number. For all others partners enter the partner's employer identification number. (However, if a partner is an individual retirement arrangement (IRA), enter the identifying number of the custodian of the IRA. Do not enter the social security number of the person for whom the IRA is maintained.)

Note: *Space has been provided on line 21 of Schedule K-1 for you to provide information to the partners. This space may be used in lieu of attachments.*

Question A

Question A must be answered for all partners. If a partner holds interests as both a general and limited partner, attach a schedule for each activity which shows the amounts allocable to the partner's interest as a limited partner.

Item B

Partner's Share of Liabilities

Enter each partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities. **Nonrecourse liabilities** are those liabilities of the partnership for which none of the partners has any personal liability. Do not include partnership-level **qualified nonrecourse financing** (defined below) on the line for nonrecourse liabilities. Nonrecourse liabilities include all nonrecourse debt on real property placed in service before 1987.

If the partner terminated his or her interest in the partnership during the year, enter the share that existed immediately before the total disposition. In all other cases, enter it as of the end of the year.

If the partnership is engaged in two or more different types of at-risk activities, or a combination of at-risk activities and any other activity, attach a statement showing the partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities for each activity. See sections 465(c)(2) and (3) and Pub. 925 to determine if the partnership is engaged in more than one at-risk activity.

If a partnership is engaged in an activity subject to the limitations of section 465(c)(1) (i.e., films or video tapes, leasing section 1245 property, farming, or oil and gas property), give each partner his or her share of the total pre-1976 losses from that activity for which there existed a corresponding amount of nonrecourse liability at the end of each year in which the losses occurred. See **Form 6198**, At-Risk Limitations, and related instructions for more information.

The at-risk rules also apply to real property, except for real property (other than mineral property) placed in service by the taxpayer before 1987. However, there is an exception for "qualified nonrecourse financing" secured by real property used in the activity of holding real property. The partner is considered at-risk for qualified nonrecourse amounts.

Qualified nonrecourse financing generally includes financing for which no one is personally liable for repayment that is secured by real property used in the activity and that is loaned or guaranteed by a Federal, state, or local government or that is borrowed from a "qualified" person. Qualified persons include any person actively and regularly engaged in the business of lending money, such as a bank or savings and loan association. Qualified persons generally do not include related parties (unless the nonrecourse financing is commercially reasonable and on substantially the same terms as loans involving unrelated persons), the seller of the property, or a person who receives a fee for the partnership's investment in the real property. See section 465 and Pub. 925 for more information on qualified nonrecourse financing.

The partner as well as the partnership must meet the qualified nonrecourse rules. Therefore, the partnership must enter on an attached statement any other information the partner needs to determine if the qualified nonrecourse rules are also met at the partner level.

Question C

What Type of Entity Is This Partner?

State on this line whether the partner is an individual, a corporation, a fiduciary, a partnership, an exempt organization, or a nominee (custodian). If the partner is a nominee, use one of the following codes to indicate the type of entity the nominee represents: I—Individual; C—Corporation; F—Fiduciary; P—Partnership; E—Exempt Organization; or IRA—Individual Retirement Arrangement.

Question D

Domestic/Foreign Partner

Check the appropriate box to indicate whether the partner is a domestic or a foreign partner.

Item E

Partner's Profit, Loss, and Capital Sharing Percentages

Enter in Item E, column (ii), the appropriate percentages as of the end of the year. However, if a partner's interest terminated during the year, enter in column (i) the percentages that existed immediately before the termination. When the profit or loss sharing percentage has changed during the year, show the percentage before the change in column (i) and the end of year percentage in column (ii). If there are multiple changes in the profit and loss sharing percentage during the year, attach a statement giving the date and percentage before each change. "Ownership of capital" means the portion of the capital that the partner would receive if the partnership was liquidated at the end of the year by the distribution of undivided interests in partnership assets and liabilities.

Items G(1) and (2)

Tax Shelter Information

If the partnership is a registration-required tax shelter, it must enter its tax shelter registration number in G(1) and identify the type of shelter in G(2). If the

partnership invested in a registration-required shelter, the partnership must also attach a copy of its Form 8271 to Schedule K-1. See Form 8271 for a list of the types of tax shelters and for more information.

Questions H(1) and (2)

These questions must be answered for all partners. The information is needed by partners to apply the phase-in relief provisions of section 469. Interests in passive activities acquired by the partner on or before October 22, 1986, are eligible for phase-in relief of the passive loss rules. Interests acquired after October 22, 1986, do not qualify for phase-in relief (unless there was a contractual obligation on October 22, 1986, to purchase the interest).

Therefore, if a partner first acquires an interest in the partnership after October 22, 1986, or a partner's ownership interest is increased after October 22, 1986, the portion of his or her interest attributable to that new interest or to the increase in the interest does not qualify for phase-in relief. For example, if after that date a partner increases his or her ownership interest from 25% to 50%, only the losses and credits attributable to the 25% interest held prior to October 23, 1986, will qualify for the phase-in relief.

Generally, to qualify for phase-in relief, the interest held by the partner must be in an activity which had commenced by October 22, 1986. If the partnership commences a new activity after that date, the new activity does not qualify for phase-in relief (unless on or before August 16, 1986, the partnership entered into a binding contract to acquire assets used to conduct the activity, or construction of the property used in the activity began).

Question H(1).—Answer "Yes" to Question H(1) if a partner's percentage of ownership interest in the partnership changed after October 22, 1986. Phase-in relief applies only with respect to the ownership interest held by the partner on October 22, 1986, and at all times thereafter. For example, if a partner reduced his or her ownership interest after October 22, 1986, from 20% to 10%, and subsequently purchased additional interests restoring his or her share to 20%, then Question H(1) should be answered "Yes," and only the 10% interest held throughout qualifies for phase-in relief.

If Question H(1) is answered "Yes," attach a statement to Schedule K-1, for Question H(1), that identifies for each activity started or acquired by the partnership **before** October 23, 1986, the amount of income, loss, deduction, and credit from each activity that is attributable to the partner's increase in ownership interest after October 22, 1986.

Question H(2).—Answer "Yes" to Question H(2) if the partnership started or acquired a new activity after October 22, 1986 (unless the binding contract or construction exceptions of section 469 apply). If the question is answered "Yes," attach a statement to Schedule K-1. Identify the income (loss), credit, etc., attributable to the activity and state that the activity was commenced after October 22, 1986. Losses and credits from such activities do not qualify for phase-in relief.

Item K

Reconciliation of Partner's Capital Account

See the instructions for Question N and Schedule M of Form 1065.

Schedules K and K-1 (unless otherwise noted)

Special Allocations

An item is specially allocated if it is allocated to a partner in a ratio that is different from the ratio for sharing income or loss generally.

Specially allocated items should be reported on the applicable lines of the partner's Schedule K-1. Report the total amount on the applicable line of Schedule K. For example, specially allocated long-term capital gain is entered on line 4e of the partner's Schedule K-1, and the total is entered on line 4e of Schedule K, along with any net long-term capital gain (or loss) from line 9 of Schedule D (Form 1065).

Income (Loss)

Line 1

Ordinary Income (Loss) From Trade or Business Activities

Enter the amount from line 21, page 1. Enter the income or loss without reference to the basis of the partners' interests in the partnership, the partners' at-risk limitations, or the passive activity limitations. These limitations, if applicable, are determined at the partner level.

If the partnership has more than one trade or business activity, identify on an attachment to Schedule K-1 the amount from each separate activity. See **Passive Activity Reporting Requirements** beginning on page 8.

Line 1 should not include rental activity income (loss) or portfolio income (loss).

Line 2

Net Income (Loss) From Rental Real Estate Activities

Enter the net income or loss from rental real estate activities of the partnership from **Form 8825,** Rental Real Estate Income and Expenses of a Partnership or an S Corporation. If the partnership has more than one rental real estate activity, identify on an attachment to Schedule K-1 the amount attributable to each activity.

If a loss from a qualified low-income housing project is reported on line 2, identify this loss on a statement attached to the Schedule K-1 of each partner who is a qualified investor in the project. Any loss sustained by a qualified investor in a qualified low-income housing project for any tax year in the relief period is not subject to the passive activity loss limitations under section 502 of the Tax Reform Act of 1986. See Act section 502 for definitions and other information on qualified low-income housing projects.

Line 3

Net Income (Loss) From Other Rental Activities

On Schedule K, line 3a, enter gross income from rental activities other than rental real estate activities. See page 6 of these instructions, section 469, and Pub. 925 for the definition of rental activities. Include on line 3a, the gain (loss) from line 18 of Form 4797 that is attributable to the sale, exchange, or involuntary conversion of an asset used in a rental activity other than a rental real estate activity.

On line 3b of Schedule K enter the deductible expenses of the activity. Attach a schedule of these expenses to Form 1065.

Enter the net income (loss) on line 3c of Schedule K. Enter each partner's share on line 3 of Schedule K-1.

If the partnership has more than one rental activity reported on line 3, identify on an attachment to Schedule K-1 the amount from each activity.

Lines 4a through 4f

Portfolio Income (Loss)

Enter portfolio income (loss) on lines 4a through 4f.

See page 7 of these instructions for a definition of portfolio income. Do not reduce portfolio income by deductions allocable to it. Portfolio deductions (other than interest expense) are reported on line 10 of Schedules K and K-1. Interest expense allocable to portfolio income is generally investment interest expense and must be reported on line 12a of Schedules K and K-1.

Lines 4a and 4b.—Enter only taxable interest and dividends on these lines.

Taxable interest is interest from all sources except interest exempt from tax, and interest on tax-free covenant bonds.

Caution: *Be sure to give each payer of interest and dividend income the partnership's correct identification number. Otherwise, the payer may withhold 20% of the interest or dividend income. The partnership may also be subject to penalties.*

Lines 4d and 4e.—Enter on line 4d of Schedule K the amount on line 4 of Schedule D (Form 1065) plus any short-term capital gain (loss) that is specially allocated to partners. Report each partner's share on line 4d of Schedule K-1.

The amount reported for line 4e of Schedule K is the amount on line 9 of Schedule D (Form 1065) plus any long-term capital gain (loss) that is specially allocated to partners. Report each partner's share on line 4e of Schedule K-1.

Caution: *If any short-term or long-term capital gain or loss is from the disposition of nondepreciable personal property used in a trade or business, it may not be treated as portfolio income. Report such*

gain or loss on line 7 of Schedules K and K-1.

Line 4f.—Report and identify other portfolio income or loss on an attachment for line 4f. For example, income reported to the partnership from a real estate mortgage investment conduit (REMIC), in which the partnership is a residual interest holder, would be reported on an attachment for line 4f.

If the partnership holds a residual interest in a REMIC, report on the attachment for line 4f the partner's share of: (1) taxable income (net loss) from the REMIC (line 1b of Schedule Q (Form 1066)), (2) "excess inclusion" (line 2c of Schedules Q (Form 1066)), and (3) section 212 expenses (line 3b of Schedules Q (Form 1066)). Do not report these section 212 expenses on line 10 of Schedules K and K-1. Because Schedule Q (Form 1066) is a quarterly statement, the partnership must follow the Schedule Q instructions to figure the amounts to report to the partner for the partnership's tax year.

Line 5

Guaranteed Payments to Partners

Enter: (1) guaranteed payments to partners for salaries and interest deducted by the partnership and reported on Form 1065, page 1, line 10; and (2) guaranteed payments to partners the partnership is required to capitalize. (See the instructions for Form 1065, line 10.)

Generally, amounts reported on line 5 are not considered to be related to a passive activity. For example, guaranteed payments for personal services paid to a partner would not be passive activity income. Likewise, interest paid to any partner is not passive activity income.

Line 6

Net Gain (Loss) Under Section 1231 (other than due to casualty or theft)

Enter on line 6 the amount shown on line 7 of Form 4797. Do not include specially allocated ordinary gains and losses or net gains or losses from involuntary conversions due to casualties or thefts on this line; report them on line 7. If the partnership has more than one activity, attach a statement to Schedule K-1 that identifies which activity the section 1231 gain (loss) relates to.

Line 7

Other Income (Loss)

Use line 7 to report other items of income, gain, or loss not included on lines 1 through 6. If the partnership has more than one activity, identify on an attachment the amount and the activity to which each amount relates.

Items to be reported on line 7 include:

- Gains from the disposition of farm recapture property (see Form 4797) and other items to which section 1252 applies.
- Gains from the disposition of an interest in oil, gas, geothermal, or other mineral properties (section 1254).
- Recoveries of tax benefit items (section 111).
- Gambling gains and losses (subject to the limitations in section 165(d)).
- Any income, gain, or loss to the partnership under section 751(b).
- Specially allocated ordinary gain (loss).
- Net gain (loss) from involuntary conversions due to casualty or theft. The amount for this line is shown on **Form 4684**, Casualties and Thefts, Section B, line 20a, 20b, or 21.

Each partner's share must be entered on Schedule K-1. Give each partner a schedule that shows the amounts to be reported on the partner's Form 4684, Section B, line 16, columns (b)(i), (b)(ii), and (c).

Note: *If there was a gain (loss) from a casualty or theft to property not used in a trade or business or for income-producing purposes, notify the partner. The partnership should not complete Form 4684 for this type of casualty or theft. Instead, each partner will complete his or her own Form 4684.*

Deductions

Line 8

Charitable Contributions

Enter the total amount of charitable contributions made by the partnership during its tax year on Schedule K. Enter each partner's distributive share on Schedule K-1. Attach an itemized list to each schedule that shows the amount subject to the 50%, 30%, and 20% limitations.

If the partnership made a qualified conservation contribution under section 170(h), include the fair market value of the underlying property before and after the donation and describe the conservation purpose furthered by the donation. Give a copy of this information to each partner.

If the partnership contributed property and the aggregate amount of the claimed value exceeds $500, **Form 8283**, Noncash Charitable Contributions, must be completed and attached to Form 1065. The partnership must give a copy of its Form 8283 to every partner if the value of an item or group of similar items of contributed property exceeds $5,000 even though the amount allocated to each partner is $5,000 or less. For property valued at $5,000 or less, the partnership does not have to furnish the partners with its Form 8283. Instead, it should pass through each partner's share of the fair market value of contributed property so the partners will be able to complete their own Forms 8283. See the instructions for Form 8283 for additional information.

Line 9

Section 179 Expense Deduction

A partnership may elect to expense part of the cost of certain tangible property the partnership purchased this year for use in its trade or business or rental activities. See Pub. 534 for a definition of what kind of property qualifies for the section 179 deduction.

Complete Part I of Form 4562 to figure the partnership's section 179 expense deduction. The partnership does not deduct the expense itself but passes the expense through to its partners. Attach Form 4562 to Form 1065 and show the total section 179 expense on Schedule K, line 9. Report each partner's allocable share on Schedule K-1, line 9. Line 9 of Schedule K-1 should not be completed for any partner that is an estate or trust.

The partnership must specify on an attachment to Schedule K-1 the items of section 179 property it elects to treat as an expense, the portion of the cost of each item treated as an expense, the portion of the cost of each item treated as a carryover amount, and the partner's allocable share of the partnership's section 179 expense deduction for the tax year.

See the instructions for line 21 of Schedule K-1, item e, for any recapture of a section 179 amount.

Note: *Generally, the amount of section 179 property the partnership may elect to expense is limited to $10,000. The $10,000 limit is reduced by the amount of section 179 property placed in service during the tax year that exceeds $200,000. The section 179 deduction for a partnership is further limited to the partnership's aggregate taxable income (gross income minus deductions, computed without regard to the section 179 deduction) from the active conduct of any trade or business during the tax year. Any amount which (but for the taxable income limitation) would have been allowed as a deduction is carried forward to a future year (section 179(b)(3)(B)).*

Line 10

Deductions Related to Portfolio Income

Enter on this line and attach an itemized list of the allowable deductions that are clearly and directly allocable to portfolio income (other than interest expense and section 212 expenses from a REMIC).

Generally, interest expense related to portfolio income is investment interest expense and is reported as a separate item on line 12a of Schedules K and K-1, instead of line 10. Section 212 expenses from the partnership's interest in a REMIC are reported on an attachment for line 4f of Schedules K and K-1.

No deduction is allowable under section 212 for expenses allocable to a convention, seminar, or similar meeting. Generally, expenses related to portfolio income are miscellaneous itemized deductions to the partner and are subject to the 2% floor of section 67 at the partner level.

Line 11

Other Deductions

Note: *Do not include in the amounts shown on line 11 qualified expenditures to which an election under section 59(e) may apply. Instead, report these amounts on line 13a.*

Use line 11 to report deductions not included on lines 8, 9, 10, and 17e. On an attachment identify the amount and the activity (if the partnership has more than one activity) to which the amount relates.

Items to be reported on line 11 include:

a. Amounts paid by the partnership that would be allowed as itemized deductions on any of the partners' income tax returns if they were paid directly by a partner for the same purpose. However, do not enter expenses related to portfolio income or investment interest expense on this line.

If there was a loss from an involuntary conversion due to casualty or theft of income-producing property, include in the total amount for this line the relevant amount from Form 4684, Section B, line 14.

b. Any penalty on early withdrawal of savings.

c. Soil and water conservation expenditures (section 175).

d. Expenditures for the removal of architectural and transportation barriers to the elderly and handicapped and which the partnership has elected to treat as a current expense (section 190).

e. Any amounts paid during the tax year for insurance which constitutes medical care for a partner, a partner's spouse, and a partner's dependents. Under the provisions of section 162(l), a partner may be allowed a deduction up to 25% of such amounts.

f. Payments for a partner to an IRA, Keogh, or SEP plan.

If there is a defined benefit plan (Keogh), attach to the Schedule K-1 for each partner a statement showing the amount of benefit accrued for the tax year.

g. Interest expense allocated to debt-financed distributions. See Notice 89-35 for more information.

Investment Interest

Lines 12a through 12b(2)

Lines 12a through 12b(2) must be completed for all partners.

Line 12a. Interest Expense on Investment Debts.—Include on this line interest paid or accrued to purchase or carry property held for investment. Property held for investment includes property that produces portfolio income (interest, dividends, annuities, royalties, etc.). Interest expense allocable to portfolio income should be reported on line 12a of Schedules K and K-1 (rather than line 10 of Schedules K and K-1).

Property held for investment includes a partner's interest in a trade or business activity that is not a passive activity to the partner and in which the partner does not materially participate. An example would be a partner's working interest in oil and gas property (where the partner's interest is not limited) in which the partner does not materially participate in the oil and gas activity.

Investment interest does not include interest expense allocable to a passive activity.

The amount on line 12a will be deducted (after applying the investment interest expense limitations of section 163(d)) by individual partners on their Form 1040.

For more information, see **Form 4952,** Investment Interest Expense Deduction.

Lines 12b(1) and 12b(2). Investment Income and Expenses.—Enter on line 12b(1) only the investment income included on line 4 of Schedules K and K-1. Enter on line 12b(2) only the investment expense included on line 10 of Schedules K and K-1.

If there are items of investment income or expense included in the amounts that are required to be passed through separately to the partner on Schedule K-1 (items other than the amounts included in lines 4 and 10 of Schedule K-1), give each partner a schedule identifying these amounts.

Investment income includes gross income from property held for investment, gain from the disposition of property held for investment, and other amounts that are gross portfolio income. Generally, investment income and investment expenses do not include any income or expenses from a passive activity. See Temporary Regulations section 1.469-2T(f)(10) for exceptions.

Property subject to a net lease is not treated as investment property because it is subject to the passive loss rules. Do not reduce investment income by losses from passive activities.

Investment expenses are deductible expenses (other than interest) directly connected with the production of investment income. See the instructions for Form 4952 for more information on investment income and expenses.

Credits

Lines 13b, 13c, 13d, 13e, and 14.—Lines 13b, 13c, 13d, and 13e are intended to help partners apply the passive activity limitations of section 469. These lines relate to rental activities. Use line 14 to report credits related to trade or business activities.

Line 13b. Low-Income Housing Credit.—Section 42 provides a credit that may be claimed by owners of low-income residential rental buildings. If the partners are eligible to take the low-income housing credit, complete and attach **Form 8586,** Low-Income Housing Credit; **Form 8609,** Low-Income Housing Credit Allocation Certification; and **Schedule A (Form 8609),** Annual Statement, to Form 1065.

Note: *No low-income housing credit can be taken with respect to any building for which any person has been allowed any benefit under 1986 Act section 502 (relating to the transitional exception rule for low-income housing).*

Report on line 13b(1) the total low-income housing credit for property placed in service before 1990 with respect to which a partnership is to be treated under section 42(j)(5) as the taxpayer to which the low-income housing credit was allowed. Report any other low-income housing credit for property placed in service before 1990 on line 13b(2). On lines 13b(3) and (4) report the low-income housing credit for property placed in service after 1989.

Line 13c. Qualified Rehabilitation Expenditures Related to Rental Real Estate Activities.—Enter total qualified rehabilitation expenditures related to rental real estate activities of the partnership, and for line 13c of Schedule K, complete the applicable lines of **Form 3468,** Investment Credit, that apply to qualified rehabilitation expenditures for property related to rental real estate activities of the partnership for which income or loss is reported on line 2 of Schedule K. See Form 3468 for details on qualified rehabilitation expenditures. Attach Form 3468 to Form 1065.

For line 13c of Schedule K-1, enter each partner's distributive share of the expenditures. On the dotted line to the left of the entry space for line 13c, enter the line number of Form 3468 on which the partner should report the expenditures. If there is more than one type of expenditure, or the expenditures are from more than one line 2 activity, report this information separately for each expenditure or activity on an attachment to Schedules K and K-1.

Note: *Qualified rehabilitation expenditures for property not related to rental real estate activities must be listed separately on line 21 of Schedule K-1.*

Lines 13d, 13e, and 14.—Enter the type of credit on the dotted line in column (a) (or in the margin) and the amount in column (b). If there is more than one type of credit or the credit is from more than one activity, report this information separately for each credit or activity on an attachment to Schedules K and K-1.

Line 13d. Credits (other than credits shown on lines 13b and 13c) Related to Rental Real Estate Activities.—Report any information that the partners need to figure credits related to a rental real estate activity, other than the low-income housing credit and qualified rehabilitation expenditures.

Line 13e. Credits Related to Other Rental Activities.—Use this line to report information that the partners need to figure credits related to a rental activity other than a rental real estate activity.

Line 14. Other Credits.—Enter each partner's allocable share of any credit that is related to a trade or business activity. The credits to be reported on line 14 and other required attachments are as follows:

- *Jobs Credit.* Complete and attach Form 5884 to Form 1065. This credit is apportioned among the partners according to their interest in the partnership at the time the wages on which the credit is computed were paid or accrued.
- *Credit for Alcohol Used as Fuel.* Complete and attach Form 6478 to Form 1065. This credit is apportioned to persons who were partners on the last day of the partnership's tax year. The credit must be included as income on page 1, line 7, of Form 1065. See section 40(f)

for an election the partnership can make to not have the credit apply.

- *Nonconventional Source Fuel Credit.* The credit is figured at the partnership level and then is apportioned to persons who were partners in the partnership on the last day of the partnership's tax year. Attach a separate schedule to the return to show the computation of the credit. See section 29 for more information.
- *Unused Credits From Cooperatives.* The unused credits are apportioned to persons who were partners in the partnership on the last day of the partnership's tax year.
- *Orphan Drug Credit and Credit for Increasing Research Activities.* Complete and attach **Form 6765**, Credit for Increasing Research Activities.
- *Disabled Access Credit.* Complete and attach **Form 8826**, Disabled Access Credit.

Note: *See the instructions for line 21 of Schedule K-1 to report the partnership's investment in property qualifying for the regular or business energy investment credit (other than from cooperatives).*

Self-Employment

Note: *If the partnership is an options dealer or a commodities dealer, see section 1402(i) before completing lines 15a, b, and c, to determine the amount of any adjustment that may have to be made to the amounts shown on the Worksheet for Figuring Net Earnings (Loss) From Self-Employment. If the partnership is engaged solely in the operation of a group investment program, earnings from the operation are not self-employment earnings for either general or limited partners.*

Worksheet Instructions

Line 1b.—In addition to the net income (loss) from Schedule K, line 3c, include on line 1b any part of the net income (loss) from rental real estate activities from Schedule K, line 2, that is from: (1) rentals received as a real estate dealer, or (2) rentals for which services were rendered to the occupants (other than those usually or customarily rendered for the rental of space for occupancy only). The supplying of maid service, for example, is such a service; but the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, trash collection, etc., are not considered services rendered to the occupants.

Lines 1d, 4b, and 6b.—Allocate the amounts on these lines in the same way Form 1065, page 1, line 21, is allocated to these particular partners.

Line 2.—Include in the amount on line 2 any guaranteed payments to partners reported on Schedules K and K-1, line 5. Also include other ordinary income and expense items (other than expense items subject to separate limitations at the partner level, such as the section 179 deduction) reported on Schedules K and K-1 that are used to compute self-employment earnings under section 1402.

Note: *Amounts paid for health insurance costs of self-employed individuals are not deductible in computing net income from self-employment.*

Line 3.—For purposes of this line only, do not enter an amount in parentheses.

Line 15a

Net Earnings (Loss) From Self-Employment

Schedule K.—Enter on line 15a the amount from line 9 of the worksheet.

Schedule K-1.—Do not complete this line for any partner that is an estate, trust, corporation, exempt organization, or Individual Retirement Arrangement (IRA).

Enter on line 15a of Schedule K-1 each individual general partner's share of the amount shown on line 7c of the worksheet. To figure an individual general partner's share of the amount on line 7c, multiply the amount on line 7c by the decimal amount you get when you divide that individual general partner's share of the amount shown on line 1c of the worksheet (using the corresponding amounts included on the partner's Schedule K-1) by the total of all individual general partners' shares of the amount shown on line 1c. Enter the amount shown on line 7b of the worksheet on the applicable individual general partner's Schedule K-1, line 15a. Add it to the partner's share of the amount on line 7c of the worksheet.

If a partner is both a general and a limited partner, add that partner's share of the amount on lines 7b and 7c to that partner's share of the amount on line 8 and enter the total on line 15a of that partner's Schedule K-1.

Limited partners.—A limited partner's share of partnership income (loss) shown on line 1, 2, or 3 of Schedule K-1 is not self-employment income. Limited partners may treat as self-employment income only

Worksheet for Figuring Net Earnings (Loss) From Self-Employment

1a	Ordinary income (loss) (Form 1065, page 1, line 21)	1a	
b	Net income (loss) from other rental activities (Schedule K, line 3c), and net income (loss) from certain rental real estate activities (see instructions)	1b	
c	Combine lines 1a and 1b	1c	
d	Part allocated to partners who are estates, trusts, corporations, exempt organizations, IRAs, or limited partners	1d	
e	Subtract line 1d from line 1c. (If line 1c is a loss, reduce line 1c by the amount on line 1d.)	1e	
2	Guaranteed payments to partners included on Schedules K-1, line 5	2	
3	Net loss from Form 4797, Part II, line 18, included on line 1c above. Enter as a positive amount	3	
4a	Total—Add lines 2 and 3	4a	
b	Part allocated to partners who are estates, trusts, corporations, exempt organizations, IRAs, or limited partners	4b	
c	Subtract line 4b from line 4a	4c	
5	Add lines 1e and 4c. (If line 1e is a loss, reduce line 1e by the amount on line 4c.)	5	
6a	Net gain from Form 4797, Part II, line 18, included on line 1c above	6a	
b	Part allocated to partners who are estates, trusts, corporations, exempt organizations, IRAs, or limited partners	6b	
c	Subtract line 6b from line 6a	6c	
7a	Subtract line 6c from line 5. (If line 5 is a loss, increase the loss on line 5 by the amount on line 6c.)	7a	
b	Guaranteed payments to individual general partners included on line 2 above. Include on line 15a of the applicable individual general partner's Schedule K-1	7b	
c	Subtract line 7b from line 7a. (If line 7a is a loss, increase the loss on line 7a by the amount on line 7b.) Include each individual general partner's share on line 15a of Schedule K-1. Add this amount to any amount from line 7b of this worksheet	7c	
8	Guaranteed payments to individual limited partners included on line 2 above. Enter here and on the applicable partner's Schedule K-1, line 15a	8	
9	Net earnings (loss) from self-employment. Add lines 7b, 7c, and 8. (If line 7c is a loss, reduce the loss on line 7c by the total of the amounts on lines 7b and 8.) Enter here and on Schedule K, line 15a	9	

guaranteed payments for services they actually rendered to, or on behalf of, the partnership to the extent that those payments are payment for those services (line 8 of the worksheet). Show only these amounts on line 15a of Schedule K-1 for a limited partner.

General partners.—General partners' net earnings (loss) from self-employment do not include:

- Dividends on any shares of stock and interest on any bonds, debentures, notes, etc., unless the dividends or interest are received in the course of a trade or business, such as a dealer in stocks or securities or interest on notes or accounts receivable.
- Rentals from real estate, except rentals received in the course of a trade or business as a real estate dealer or payments for rooms or space when significant services are provided.
- Royalty income, except royalty income received in the course of a trade or business.

See the instructions for **Schedule SE (Form 1040)**, Social Security Self-Employment Tax, for more information.

Line 15b

Gross Farming or Fishing Income

Enter the gross farming or fishing income needed by an individual partner to figure net earnings from self-employment under the optional method in Section B, Part II of Schedule SE (Form 1040).

Line 15c

Gross Nonfarm Income

Enter the gross nonfarm income needed by an individual partner to figure net earnings from self-employment under the optional method in Section B, Part II of Schedule SE (Form 1040).

Adjustments and Tax Preference Items

Lines 16a through 16f

Lines 16a through 16f must be completed for all partners.

Enter items of income and deductions that are adjustments or tax preference items. See **Form 6251,** Alternative Minimum Tax—Individuals, **Form 4626,** Alternative Minimum Tax—Corporations, **Form 8656,** Alternative Minimum Tax—Fiduciaries, and **Pub. 909,** Alternative Minimum Tax for Individuals, to determine the amounts to enter and for other information.

Do not include as a tax preference item any qualified expenditures to which an election under section 59(e) may apply. Instead, report these expenditures on lines 18a and 18b. Because these expenditures are subject to an election by each partner, the partnership cannot compute the amount of any tax preference related to them.

Line 16c. Depreciation Adjustment on Property Placed in Service After 1986.—Figure the adjustment for line 16c based only on tangible property placed in service after 1986 (and tangible property placed in service after July 31, 1986, and before 1987 for which the partnership elected to use the General Depreciation System). Refigure depreciation as follows: For property other than real property and property on which the straight line method was used, use the 150% declining balance method, switching to straight line for the first tax year that method gives a better result. For property on which the straight line method was used, use the straight line method. Use the class life (instead of the recovery period) and the same conventions that you used on Form 4562. For personal property having no class life, use 12 years. For residential rental and nonresidential real property, use the straight line method over 40 years. Determine the depreciation adjustment by subtracting the recomputed depreciation from the depreciation claimed on Form 4562. If the recomputed depreciation exceeds the depreciation claimed on Form 4562, enter the difference as a negative amount. See Form 6251 for more information.

Line 16d. Depletion (Other Than Oil and Gas).—Do not include any depletion on oil and gas wells. The partners must compute both their depletion deduction and their depletion preference item separately.

In the case of mines, wells, and other natural deposits, other than oil and gas wells, enter the amount by which the deduction for depletion under section 611 (including percentage depletion for geothermal deposits) is more than the adjusted basis of such property at the end of the tax year. Figure the adjusted basis without regard to the depletion deduction for the tax year and figure the excess separately for each property.

Lines 16e(1) and 16e(2).—Enter only the income and deductions for oil, gas, and geothermal properties that are used to figure the partnership's ordinary income or loss (line 21 of Form 1065). If there are items of income or deduction for oil, gas, and geothermal properties included in the amounts required to be passed through separately to the partners on Schedule K-1 (items not reported in line 1 of Schedule K-1), give each partner a schedule identifying these amounts.

Figure the amount for lines 16e(1) and (2) separately for oil and gas properties which are not geothermal deposits and for all properties which are geothermal deposits.

Give each partner a schedule that shows the separate amounts that are included in the computation of the amounts on lines 16e(1) and (2).

Line 16e(1). Gross Income From Oil, Gas, and Geothermal Properties.—Enter the aggregate amount of gross income (within the meaning of section 613(a)) from all oil, gas, and geothermal properties that was received or accrued during the tax year and included on page 1, Form 1065.

Line 16e(2). Deductions Allocable to Oil, Gas, and Geothermal Properties.—Enter the amount of any deductions allocable to oil, gas, and geothermal properties reduced by the excess intangible drilling costs that were included on page 1, Form 1065, on properties for which the partnership made the election to expense intangible drilling costs in tax years beginning before 1983. Do not include on line 16e nonproductive well costs or the amount shown on line 16b, page 1, Form 1065. Instead, use any applicable amount on line 16c, page 1, Form 1065.

See Form 6251 for information on how to compute excess intangible drilling costs.

Line 16f. Other Adjustments and Tax Preference Items.—Attach a schedule which shows each partner's share of other items not shown on lines 16a through 16e(2) that are adjustments or tax preference items or that the partner needs to complete Form 6251, Form 4626, or Form 8656. See these forms and their instructions to determine the amount to enter.

Other adjustments or tax preference items include the following:

- Long-term contracts entered into after February 28, 1986. Except for certain home construction contracts, the taxable income from these contracts must be figured using the percentage of completion method of accounting for alternative minimum tax purposes.
- Installment sales of inventory or stock in trade after March 1, 1986. Generally, the installment method may not be used for these sales in computing alternative minimum taxable income.
- Losses from tax shelter farm activities. No loss from any tax shelter farm activity is allowed for alternative minimum tax purposes.
- Charitable contributions of appreciated property. Generally, the deduction for charitable contributions is reduced by the difference between the fair market value and the adjusted basis of the capital gain and section 1231 property donated to a charitable organization.

Foreign Taxes

Lines 17a through 17g

Lines 17a through 17g must be completed whether or not a partner is eligible for the foreign tax credit.

In addition to the instructions below, see the following for more information:

- **Form 1116,** Foreign Tax Credit—Individual, Fiduciary, or Nonresident Alien Individual, and the related instructions.
- **Form 1118,** Foreign Tax Credit—Corporations, and the related instructions.
- **Pub. 514,** Foreign Tax Credit for Individuals.

Line 17a. Type of Income.—Enter the type of income from outside the U.S. as follows:

- Passive income
- High withholding tax interest
- Financial services income
- Shipping income
- Dividends from a DISC or former DISC
- Distributions from a foreign sales corporation (FSC) or former FSC

- Dividends from each noncontrolled section 902 corporation
- Taxable income attributable to foreign trade income (within the meaning of section 923(b))
- General limitation income—all other income from sources outside the United States (including income from sources within U.S. possessions)

If, for the country or U.S. possession shown on line 17b, the partnership had **more than one** type of income, enter **"See attached"** and attach a schedule for each type of income for lines 17c through 17g.

Line 17b. Foreign Country or U.S. Possession.—Enter the name of the foreign country or U.S. possession. If, for the type of income shown on line 17a, the partnership had income from, or paid taxes to, **more than one** foreign country or U.S. possession, enter **"See attached"** and attach a schedule for each country for lines 17a and 17c through 17g.

Line 17c. Total Gross Income From Sources Outside the U.S.—Enter in U.S. dollars the total gross income from sources outside the U.S. Attach a schedule that shows each type of income listed in the instructions for line 17a.

See section 904(d) for types of income that must be reported to partners for figuring their foreign tax credit.

Line 17d. Total Applicable Deductions and Losses.—Enter in U.S. dollars the total applicable deductions and losses. Attach a schedule that shows each type of deduction or loss as follows:

- expenses directly allocable to each type of income;
- pro rata share of all other deductions not directly allocable to specific items of income; and
- pro rata share of losses from other separate limitation categories.

Line 17e. Total Foreign Taxes.—Enter in U.S. dollars the total foreign taxes (described in section 901) that were paid or accrued by the partnership to foreign countries or U.S. possessions. Attach a schedule that shows the dates the taxes were paid or accrued, and the amount in both foreign currency and in U.S. dollars, as follows:

- taxes withheld at source on dividends;
- taxes withheld at source on rents and royalties; and
- other foreign taxes paid or accrued.

Line 17f. Reduction in Taxes Available for Credit.—Enter in U.S. dollars, the total reduction in taxes available for credit. Attach a schedule that shows separately the:

- reduction for foreign mineral income (section 901(e));
- reduction for failure to furnish returns required under section 6038;
- reduction for taxes attributable to boycott operations (section 908);
- reduction for foreign oil and gas extraction income (section 907(a)); and
- reduction for any other items (specify).

Line 17g. Other Foreign Tax Information.—Enter in U.S. dollars any items not covered on lines 17c, 17d, 17e, and 17f, such as gross income and definitely allocable deductions from sources outside the United States and for foreign branches, for corporate partners (Form 1118, Schedule F).

Other

Lines 18a and 18b.—Generally, section 59(e) allows each partner to make an election to deduct the partner's distributive share of the partnership's otherwise deductible qualified expenditures ratably over 10 years (3 years for circulation expenditures), beginning with the tax year in which the expenditures were made (or for intangible drilling and development costs, over the 60-month period beginning with the month in which such costs were paid or incurred). The term "qualified expenditures" includes only the following types of expenditures paid or incurred during the tax year: circulation expenditures, research and experimental expenditures, intangible drilling and development costs, and mining exploration and development costs. If a partner makes this election, these items are not treated as tax preference items.

Because the partners are generally allowed to make this election, the partnership cannot deduct these amounts or include them as adjustments or tax preference items on Schedule K-1. Instead, on lines 18a and 18b of Schedule K-1, the partnership passes through the information the partners need to compute their separate deductions.

Enter on line 18a the qualified expenditures paid or incurred during the tax year to which an election under section 59(e) may apply. Enter this amount for all partners whether or not any partner makes an election under section 59(e). On line 18b, enter the type of expenditures claimed on line 18a. If the expenditures are for intangible drilling and development costs, enter the month in which the expenditures were paid or incurred (after the type of expenditure on line 18b). If there is more than one type of expenditure included in the total shown on line 18a (or intangible drilling and development costs were paid or incurred for more than one month), report this information separately for each type of expenditure (or month) on an attachment to Schedules K and K-1.

Line 19 (Schedule K only).—Attach a statement to Schedule K to report the partnership's total income, expenditures, or other information for items a through o of the line 21 (Schedule K-1) instructions on page 23.

Recapture of Tax Credits

Lines 19a and 19b (Schedule K-1 only). Recapture of Low-Income Housing Credit.—If there has been a decrease in the qualified basis of a building from the prior year or if the partnership disposed of the building or of an ownership interest in it, the partnership may be required to recapture part of a credit claimed in a prior year. If recapture applies, the partnership must attach **Form 8611,** Recapture of Low-Income Housing Credit, to Form 1065.

See the instructions for Form 8611 regarding the specific information that the partnership must provide to each partner when recapture is required.

Note: *In certain instances, a transaction by a partner may result in recapture at the partner level. In such cases, the partnership will be required to provide the partner with the information that the partner needs in order to correctly compute the recapture amount.*

Report on line 19a the total low-income housing credit recapture with respect to a partnership treated under section 42(j)(5) as the taxpayer to which the low-income housing credit was allowed. Report any other low-income housing credit recapture on line 19b.

If the partnership has posted a bond as provided in section 42(j)(6) to avoid recapture, no entry should be made on line 19 of Schedule K-1.

See Form 8586, Form 8611, and section 42 for more information.

Lines 20a through 20e (Schedule K-1 only) Investment Credit Properties Subject to Recapture.—Complete line 20 when regular or energy investment credit property is disposed of, ceases to qualify, or there is a decrease in the percentage of business use before the end of the recapture period or the useful life used to figure the original credit. Lines 20a through 20e must be completed whether or not a partner is subject to the recapture of investment credit. For more information, see **Form 4255,** Recapture of Investment Credit.

Line 20b. Analysis of Total Distributive Income/Payment Items by Type of Partner (Schedule K only).—For each type of partner shown, enter the portion of the amount shown on line 20a of Schedule K that was allocated to that type of partner. The sum of the amounts shown on line 20b must equal the amount shown on line 20a.

In classifying partners who are individuals as "active" or "passive," the partnership should apply the rules below. In applying these rules, a partnership should classify each partner to the best of its knowledge and belief. It is assumed that in most cases the level of a particular partner's participation in an activity will be apparent:

1. If the partnership's principal activity is a trade or business, classify a general partner as "active" if the partner materially participated in all partnership trade or business activities; otherwise, classify a general partner as "passive."

2. If the partnership's principal activity consists of a working interest in an oil or gas well, classify a partner holding a working interest in the oil or gas well through an entity that does not limit the partner's liability as "active"; otherwise, classify the partner as "passive."

3. If the partnership's principal activity is a rental real estate activity, classify a general partner as "active" if the partner actively participated in all of the partnership's rental real estate activities;

otherwise, classify a general partner as "passive."

4. If the partnership's principal activity is a portfolio activity, classify all partners as "active."

5. Classify all limited partners and all partners in a partnership whose principal activity is a rental activity other than a rental real estate activity as "passive."

6. If the partnership cannot make a reasonable determination whether a partner's participation in a trade or business activity is material or whether a partner's participation in a rental real estate activity is active, classify the partner as "passive."

Line 21 (Schedule K-1 only)

Enter in the line 21 Supplemental Information space of Schedule K-1, or on an attached schedule if more space is needed, each partner's share of any information asked for on lines 7 through 20 that is required to be reported in detail, and items **a** through **o** below. Please identify the applicable line number next to the information entered in the Supplemental Information space. Show income or gains as a positive number. Show losses in parentheses.

a. Taxes paid on undistributed capital gains by a regulated investment company. As a shareholder of a regulated investment company, the partnership will receive notice on **Form 2439,** Notice to Shareholder of Undistributed Long-Term Capital Gains, that the company paid tax on undistributed capital gains.

b. The number of gallons of each fuel used during the tax year and the appropriate tax rate for each type of use identified on **Form 4136,** Credit for Federal Tax on Fuels, and in the related instructions. Each partner's share of the credit for qualified diesel-powered highway vehicles as shown on Form 4136.

c. The partner's share of gross income from each property, share of production for the tax year, etc., needed to figure the partner's depletion deduction for oil and gas wells. The partnership should also allocate to each partner a proportionate share of the adjusted basis of each partnership oil or gas property. The allocation of the basis of each property is made as specified in section 613A(c)(7)(D).

The partnership cannot deduct depletion on oil and gas wells. The partner must determine the allowable amount to report on his or her return. See Pub. 535 for more information.

d. Tax-exempt interest income, including exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

e. Recapture of expense deduction for recovery property (section 179). For property placed in service after 1986, the section 179 expense deduction is recaptured at any time the business use of the property drops to 50% or less. Enter the amount that was originally passed through to the partners and the partnership's tax year in which the amount was passed through. Tell the partner if the recapture amount was caused by the disposition of the recovery property. Do not include this amount in the partnership's income.

f. Any items the partners need to determine the basis of their interest for purposes of section 704(d) because Schedule M and Item K on Schedule K-1 are not completed; or any items (other than those shown in Item B) the partners need to figure their amount at risk.

g. Any information or statements the partners need to comply with section 6111 (registration of tax shelters) or section 6662(d)(2)(B)(ii) (regarding adequate disclosure of items that may cause an understatement of income tax).

h. The partner's share of farm production expenses, if the partnership is not required to use the accrual method of accounting. See Temporary Regulations section 1.263A-1T(c).

i. Any information needed by a partner to compute the interest due under section 453(l)(3). If the partnership elected to report the disposition of certain timeshares and residential lots on the installment method, each partner's tax liability must be increased by the partner's allocable share of the interest on tax attributable to the installment payments received during the tax year.

j. Any information needed by a partner to compute interest due under section 453A(c). If an obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the year, report each partner's allocable share of the outstanding installment obligation to which section 453A(b) applies.

k. For closely held partnerships (as defined in section 460(b)(5)), provide the information needed by a partner to compute the partner's allocable share of any interest due or to be refunded under the look-back method of section 460(b)(3) on certain long-term contracts entered into after February 28, 1986, that are accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method. Also attach to Form 1065 the information specified in the instructions for line 2, Form 8697, for each tax year in which such a long-term contract is completed.

l. Any information needed by a partner relating to interest expense that the partner is required to capitalize. Under section 263A, a partner may be required to capitalize interest expense incurred by the partner during the tax year with respect to the production expenditures of the partnership. Similarly, interest incurred by a partnership may have to be capitalized by a partner with respect to the partner's own production expenditures. The information required by the partner to properly capitalize interest for this purpose must be provided on an attachment to Schedule K-1. See Notice 88-99 for more information.

m. Any information a partner that is a tax-exempt organization may need to compute that partner's share of unrelated business taxable income under section 512(a)(1) (but excluding any modifications required by paragraphs (8) through (15) of section 512(b)).

Note: *Partners are required to notify the partnership of their tax-exempt status.*

n. Investment in property qualifying for the regular or business energy investment credit. Complete and attach Form 3468 to Form 1065. See Form 3468 and the related instructions for information on eligible property and the lines on Form 3468 to complete. Do not include that part of the cost of the property the partnership has elected to expense under section 179. Attach to each Schedule K-1 a separate schedule in a format similar to that shown on Form 3468 detailing each partner's share of any regular investment credit property, qualified energy property, and qualified rehabilitation expenditures not related to rental real estate activities. Also indicate the lines of Form 3468 on which the partners should report these amounts.

o. Any other information a partner may need to file his or her return that is not shown anywhere else on Schedule K-1. For example, if one of the partners is a pension plan, that partner may need special information to properly file its tax return.

Codes for Principal Business Activity and Principal Product or Service

These codes for the Principal Business Activity are designed to classify an enterprise by the type of activity in which it is engaged to facilitate the administration of the Internal Revenue Code. Though similar in format and structure to the Standard Industrial Classification Codes (SIC), they should not be used as SIC codes.

Using the list below, enter on page 1, Item C, the code for the specific industry group for which the largest percentage of "total assets (Schedule L, line 14, column (d))" is used.

In Item A, state the principal business activity. In Item B, state the principal product or service which accounts for the largest percentage of total assets. For example, if the principal business activity is "Retail food store," the principal product or service may be "dairy products."

Agriculture, Forestry, and Fishing

Code

Farms:

0120 Field crop.
0160 Vegetable and melon farms.
0170 Fruit and nut tree farms.
0180 Horticultural specialty.
0211 Beef cattle feedlots.
0212 Beef cattle, except feedlots.
0215 Hogs, sheep, and goats.
0240 Dairy farms.
0250 Poultry and eggs.
0260 General livestock (except animal specialty).
0270 Animal specialty.

Agricultural services and forestry:

0740 Veterinary services.
0753 Livestock breeding.
0754 Animal services, except livestock breeding and veterinary.
0780 Landscape and horticultural services.
0790 Other agricultural services.
0800 Forestry, except logging.
2400 Logging.

Fishing, hunting, and trapping:

0930 Commercial fishing, hatcheries, and preserves.
0970 Hunting, trapping, and game propagation.

Mining

1000 Metal mining.
1200 Coal mining.
1300 Oil and gas extraction.
1400 Nonmetallic minerals except fuel.

Construction

General building contractors and operative builders:

1510 General building contractors.
1531 Operative builders.

Heavy construction contractors:

1611 Highway and street construction.
1620 Heavy construction, except highway.

Special trade contractors:

1711 Plumbing, heating, and air conditioning.
1721 Painting, paperhanging, and decorating.
1731 Electrical work.
1740 Masonry, drywall, stone, tile.
1750 Carpentering and flooring.
1761 Roofing, siding, and sheet metal.
1771 Concrete work.
1781 Water well drilling.
1790 Other building trade contractors (excavation, glazing, etc.)

Manufacturing

2000 Food and kindred products.
2200 Textile mill products.
2300 Apparel and other textile products.
2400 Lumber and wood products, except furniture.
2500 Furniture and fixtures.
2700 Printing, publishing, and allied industries.
2800 Chemicals and allied products.
3000 Rubber and plastic products.
3100 Leather and leather products.
3200 Stone, clay, and glass products.
3300 Primary metal industries.
3400 Fabricated metal products.
3500 Machinery, except electrical.
3600 Electrical and electronic equipment.
3700 Transportation equipment.
3970 Other manufacturing industries.

Transportation, Communication, Electric, Gas, and Sanitary Services

Code

Local and interurban passenger transit:

4121 Taxicabs.
4189 Other passenger transportation.

Trucking and warehousing:

4210 Trucking (local and long distance), except trash collection.
4216 Trash collection without own dump.
4220 Public warehousing.

Other transportation including transportation services:

4400 Water transportation.
4540 Transportation by air.
4722 Passenger transportation arrangement.
4799 Other transportation services.
4800 Communication.
4900 Utilities, including steamships, snowplowing, etc.

Wholesale Trade—Selling Goods to Other Businesses, Government, or Institutions, etc.

Durable goods, including machinery, equipment, wood, metals, etc.:

5001 Selling for your own account.
5002 Agent or broker for other firms—more than 50% of gross sales on commission.

Nondurable goods, including food, fiber, chemicals, etc.:

5101 Selling for your own account.
5102 Agent or broker for other firms—more than 50% of gross sales on commission.

Retail Trade

Building materials, hardware, garden supply, and mobile home dealers:

5211 Lumber and other building materials dealers.
5231 Paint, glass, and wallpaper stores.
5251 Hardware stores.
5261 Retail nurseries and garden stores.
5271 Mobile home dealers.

General merchandise:

5331 Variety stores.
5398 Other general merchandise stores.

Food stores:

5411 Grocery stores.
5420 Meat and fish markets freezer provisioners.
5431 Fruit stores and vegetable markets.
5441 Candy, nut, and confectionery stores.
5451 Dairy products stores.
5460 Retail bakeries.
5490 Other food stores.

Automotive dealers and service stations:

5511 New car dealers (franchised).
5521 Used car dealers.
5531 Auto and home supply stores.
5541 Gasoline service stations.
5551 Boat dealers.
5561 Recreational vehicle dealers.
5571 Motorcycle dealers.
5599 Aircraft, and other automotive dealers.

Apparel and accessory stores:

5611 Men's and boys' clothing and furnishings.
5621 Women's ready-to-wear stores.
5631 Women's accessory and specialty stores.
5641 Children's and infants' wear stores.
5651 Family clothing stores.
5661 Shoe stores.
5681 Furriers and fur shops.
5699 Other apparel and accessory stores.

Code

Furniture, home furnishings, and equipment stores:

5712 Furniture stores.
5713 Floor covering stores.
5714 Drapery, curtain, and upholstery stores.
5719 Home furnishings, except appliances.
5722 Household appliance stores.
5732 Radio and television stores.
5733 Music stores.
5734 Computer and software stores.

Eating and drinking places:

5812 Eating places.
5813 Drinking places.

Miscellaneous retail stores:

5912 Drug stores and proprietary stores.
5921 Liquor stores.
5932 Used merchandise and antique stores (except motor vehicle parts).
5941 Sporting goods stores and bicycle shops.
5942 Book stores.
5943 Stationery stores.
5944 Jewelry stores.
5945 Hobby, toy, and game shops.
5946 Camera and photographic supply stores.
5947 Gift, novelty, and souvenir shops.
5948 Luggage and leather goods stores.
5949 Sewing, needlework, and piece goods stores.
5961 Mail order houses.
5962 Merchandising machine operators.
5963 Direct selling organizations.
5983 Fuel oil dealers.
5984 Liquefied petroleum gas (bottled gas) dealers.
5989 Other fuel dealers (except gasoline)
5992 Florists.
5996 Other miscellaneous retail stores.

Finance, Insurance, and Real Estate

6000 Banking.
6100 Credit agencies other than banks.

Security and commodity brokers, dealers, exchanges, and services:

6212 Security underwriting syndicates.
6218 Security brokers and dealers, except underwriting syndicates.
6299 Commodity contracts brokers and dealers; security and commodity exchanges; and allied services.

Real estate:

6411 Insurance agents, brokers, and services.
6511 Real estate operators (except developers) and lessors of buildings.
6520 Lessors of real property other than buildings.
6531 Real estate agents, brokers, and managers.
6541 Title abstract offices.
6552 Subdividers and developers, except cemeteries.
6553 Cemetery subdividers and developers.

Holding and other investment companies:

6746 Investment clubs.
6747 Common trust funds.
6748 Other holding and investment companies.

Services

Hotels and other lodging places:

7012 Hotels.
7013 Motels, motor hotels, and tourist courts.
7021 Rooming and boarding houses.
7032 Sporting and recreational camps.
7033 Trailer parks and camp sites.

Code

Personal services:

7215 Coin-operated laundries and dry cleaning.
7219 Other laundry, cleaning, and garment services.
7221 Photographic studios and portrait studios.
7231 Beauty shops.
7241 Barber shops.
7251 Shoe repair and hat cleaning shops.
7261 Funeral services and crematories.
7291 Income tax preparation.
7299 Miscellaneous personal services.

Business services:

7310 Advertising.
7340 Janitorial and window cleaning.
7350 Equipment rental and leasing.
7370 Computer and data processing services.
7398 Other business services.

Automotive repair and services:

7510 Automotive rentals and leasing, without drivers.
7520 Automobile parking.
7538 General automobile repair shops.
7539 Other automotive repair shops.
7540 Automotive services, except repair.

Miscellaneous repair services:

7622 Radio and TV repair shops.
7628 Electrical repair shops, except radio and TV.
7641 Reupholstery and furniture repair.
7680 Other miscellaneous repair shops.

Motion picture:

7812 Other motion picture and TV film and tape activities.
7830 Motion picture theaters.
7840 Video tape rental stores.

Amusement and recreation services:

7920 Producers, orchestras, and entertainers.
7933 Bowling alleys.
7941 Professional sports clubs and promoters.
7948 Racing, including track operation.
7980 Other amusement and recreation services.
7991 Physical fitness facilities.

Medical and health services:

8011 Offices and clinics of medical doctors (MD's).
8021 Offices and clinics of dentists.
8031 Offices of osteopathic physicians.
8041 Offices of chiropractors.
8042 Offices of optometrists.
8047 Other licensed health practitioners.
8048 Registered and practical nurses.
8050 Nursing and personal care facilities.
8060 Hospitals.
8072 Dental laboratories.
8098 Other medical and health services.

Other services:

8111 Legal services.
8200 Educational services.
8351 Child day care.
8722 Certified public accountants.
8723 Other accounting, auditing, and bookkeeping services.
8740 Management, consulting, and public relations services.
8911 Engineering and architectural services.
8999 Other services not classified elsewhere.

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